

# Memo

**To:** Justin Schrader, Chair, Macroprudential (E) Working Group  
Marlene Caride, Chair, Financial Stability (E) Task Force

---

**From:** Tricia Matson, Partner and Edward Toy, Director

---

**Date:** January 3, 2022

---

**Subject:** RRC comments regarding Regulatory Considerations Applicable (But Not Exclusive) to PE Owned Insurers

---

## Background

The Macroprudential (E) Working Group (MWG) and Financial Stability (E) Task Force (FSTF) exposed for comment a set of Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers (Considerations). RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and the MWG and/or FSTF members.

## RRC Comments

- We have the following general comments on the Considerations:
  - We applaud these efforts. Overall, we agree with the considerations listed, and have encountered nearly all of them in our work with regulators reviewing insurer complex investments, PE acquisitions, captive formations, ownership changes, and use of offshore reinsurance.
  - We also agree that the considerations are not unique to PE owned insurers, and most, if not all, of the considerations could also apply to a non-PE owned insurance entity.
- We have the following specific comments on individual Considerations:
  - Regarding items 2 and 3, there has been significant growth in the reliance of insurers on investment managers outside of the insurance legal entities. Those investment managers may be unaffiliated, affiliated through a holding company, or formerly affiliated through a prior owner. In addition to the concerns expressed in your Considerations, there may be inadequate protections for the insurer, and therefore the policyholders, against various conflicts of interest or the investment manager engaging in investment practices that are not in the best interest of the insurer. This includes inappropriate or excessive trading, and cross trading with the investment managers other clients.
  - Regarding item 4, we agree with the consideration, and suggest also explicitly mentioning asset-liability management. We have found in some cases that increasing short term yields has resulted in insufficient consideration of longer-term management of asset and liability cash flows and economic characteristics (such as duration).

- Regarding item 6, we generally agree that a PE definition may not be required since the considerations should apply beyond PE owned insurers. We also believe that attempts to define a PE relationship or focus on only a narrow group of transaction types would only lead to efforts to work around the definition or migrate to other transaction types. A more principles-based approach would serve to mitigate this possibility.
- Regarding item 8, we have experienced situations where parties have argued that transactions are not affiliated by relying on highly nuanced technicalities. We suggest that the guidance could be revisited to ensure that it is principles-based and encompasses all intended transactions.
- Regarding item 10, we note that there are several asset classes that present unique challenges due to their complexity, opaqueness, volatility and illiquidity. This includes both private and public securities; structured securities and structured notes, investments reported on Schedule BA, and different kinds of mortgage loans. While these complex investments can provide benefits to the insurer and the policyholder (typically in the form of higher yields), it is critical that the reserves and capital supporting the business appropriately take the additional risk exposures into account.
- Regarding item 12, we agree with the commentary but note that the exposed LATF comments regarding an Actuarial Guideline may cover the issue of complex investments and their treatment in reserves across multiple product lines, and not just pension risk transfer. We believe it is appropriate to develop guidance on the treatment of complex assets in reserving for all products, as we have seen the use of private investments and structured securities in a wide range of product types, and the risk associated with them is not always captured in determining if reserves are adequate.
- We have the following potential additional considerations that the MWG and FSTF may wish to incorporate into the work:
  - Corporate governance may be structured such that decision making resides in a small number of individuals, whose interest may conflict at times with policyholder interests. For example, if Board members have a narrow background that does not adequately cover insurance (including insurance company investments) knowledge, or if there is not an adequate ability for second line (ERM) and third line (internal audit) to effectively review and challenge management, decisions may focus on short term earnings rather than long term policyholder interests.
  - Conditions that are placed on buyers of insurance businesses during the regulatory review process are sometimes confidential, making it challenging for regulators to achieve consistency across states/deals/companies in the mechanisms used to maintain policyholder protection during the Form A review process.
  - Strategic asset allocations may be designed to maximize yield while minimizing required capital charges, resulting in increased risk without a commensurate increase in capital held to protect against the risk. For example, public equity or lower quality bonds (which have relatively high capital charges for the risk) may be exchanged for more complex assets that may not have capital charges appropriate for the risk. Asset classes and types that have not been significant investments among insurers may not have a long enough history to enable management to truly understand the risk. Additionally, long-dated or illiquid (and therefore higher yielding) investments may be used that result in asset-liability mismatch, a risk that is also not well captured in RBC.

Thank you for the opportunity to provide comments on this important initiative. We can be reached at [tricia.matson@riskreg.com](mailto:tricia.matson@riskreg.com)/(860) 305-0701 and [edward.toy@riskreg.com](mailto:edward.toy@riskreg.com)/(917)561-5605 if you or other MWG or FSTF members have any questions.



NATIONAL ALLIANCE OF LIFE COMPANIES

*An Association of Life and Health Insurance Companies*

January 18, 2022

Mr. Todd Sells  
Director, Financial Regulatory Policy & Data  
National Association of Insurance Commissioners  
Kansas City, Missouri

**Re: Comments on Regulatory Considerations Applicable (But Not Exclusive) to Private Equity Owned Insurers**

Dear Mr. Sells:

I serve as Executive Director of the National Alliance of Life Companies (the NALC), a trade group of over fifty (50) life and health insurance companies and associates. We represent the interests of small and mid-sized insurance companies across the United States.

We appreciate the opportunity to provide comments on the Financial Stability Task Force's exposure on Regulatory Considerations Applicable (But Not Exclusive) to Private Equity ("PE") Owned Insurers ("Regulatory Considerations"). Our comments center on two overall considerations: 1) this initiative should be focused on insurer activities, as opposed to ownership structure; and 2) any regulatory proposal resulting from this initiative should directly relate to a clearly articulated regulatory concern and be narrowly tailored to address that concern.

Our members include insurers with multiple ownership structures. While this initiative is framed as focused on PE-owned insurers, virtually all of the considerations are not exclusive to PE-owned companies, as the title of the Regulatory Considerations acknowledges. Moreover, nearly all of the Regulatory Considerations highlight activities of insurers, regardless of ownership structure. We therefore suggest rethinking the way this workstream is framed to help ensure that certain forms of ownership structures are not wrongly deemed to be inherently risky.

We support the effort to identify recent and ongoing initiatives that are designed to address some of the issues outlined in the Regulatory Considerations. As the document highlights, the NAIC has added (or is in the process of analyzing) new disclosures, filings, and tools to address several of the perceived regulatory concerns in the Regulatory Considerations.<sup>1</sup> For that reason, we encourage continued study and analysis of whether these new disclosures, filings, and tools provide regulators the necessary analytical framework to continue the NAIC's long history of robust solvency regulation, and urge regulators to carefully consider the necessity of and impact from any additional changes on industry. As insurers continue to serve policyholders in a low interest rate environment, companies must be able to manage assets with some degree of certainty. We therefore suggest that: 1) regulators and NAIC staff continue to study whether existing and new/developing

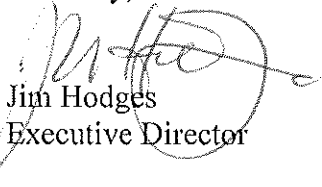
---

<sup>1</sup> For example, beginning in 2022, insurers will provide private letter rating rationale reports to the NAIC Securities Valuation Office ("SVO") and additional disclosure information in their annual financial statements.

disclosures, filings and tools provide regulators with the information necessary to address any concerns behind the Regulatory Considerations; 2) thereafter regulators and staff clearly articulate to industry any perceived regulatory gaps, with a meaningful opportunity to provide feedback and analysis; and 3) any proposal to address an identified regulatory gap be narrowly constructed to avoid unnecessary burdens and unintended consequences.

Again, we appreciate the opportunity to provide comments on this exposure and look forward to ongoing engagement with the NAIC as this work continues. Let me know if we can provide additional information or feedback.

Sincerely,



Jim Hodges  
Executive Director



January 18, 2022

VIA ELECTRONIC SUBMISSION

Todd Sells  
Director, Financial Regulatory Policy & Data  
National Association of Insurance Commissioners

**Re: Public Comment on NAIC Regulatory Considerations Regarding Private Equity-Owned Insurance Companies**

Dear Mr. Sells:

The American Investment Council (the “AIC”) is pleased that the National Association of Insurance Commissioners (the “NAIC”) is seeking to further understand the relationship between private equity and insurance as outlined in the NAIC’s Financial Stability Task Force (the “Task Force”) considerations issued as part of the Task Force’s December 7, 2021 virtual meeting and supports the review. The AIC’s members also have experience with the investment needs of insurance companies, and the AIC would be pleased to be a resource to the NAIC in regard to the matters set out in the December 7, 2021 considerations.

The AIC is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes, and distributes information about the private equity and private credit industries and their contributions to the U.S. and global economy. Established in 2007 and formerly known as the Private Equity Growth Capital Council, the AIC is based in Washington, D.C. The AIC’s members are the world’s leading private equity and private credit firms (collectively, “Alternative Asset Managers”), united by their commitment to growing and strengthening the businesses in which they invest and to helping secure the retirements of millions of pension holders and insurance policyholders.<sup>1</sup>

U.S. retirees, and the insurance companies and pension funds that invest on their behalf, are facing an unprecedented low interest rate environment even with rate increases by the Federal Reserve in the near term. Accordingly, 97% of investors

---

<sup>1</sup> For further information about the AIC and its members, please visit our website at <http://www.investmentcouncil.org>.

recently polled by Preqin expect allocations to alternatives to increase (81%) or remain steady (16%) by 2025.<sup>2</sup> With respect to insurance companies specifically, it is difficult for traditional insurance company asset managers to achieve the yield targets they have achieved historically on their debt portfolios. This leaves them with two essential choices: (1) take more risk along the yield curve in search of higher rates of return; or (2) seek other types of debt instruments that offer modestly better returns without incremental credit risk. This set of circumstances is what is driving more insurance companies to seek out the services of Alternative Asset Managers with private credit expertise to manage a portion of their assets. Insurance companies should have access to the products AIC members offer because their products are often well-suited to supporting the long-term liabilities of insurance companies. The ability to source, underwrite, and execute private credit transactions requires skill sets, experience, and scale that many insurance companies do not possess in-house. Moreover, engaging an asset manager with differentiated capabilities can be more cost efficient for an insurance company than making significant investments in an internal asset management function. By availing themselves of these advantages, insurance companies, while operating in a low-yield environment, can benefit from cost-effective sourcing and origination capabilities in specialty asset classes. This strategy results in enhanced long-term adequacy margin for policyholders, increased spread/earnings, and more competitive pricing.

There is a natural alignment between the long-dated insurance liabilities and the long-term investment approach taken by private credit managers. This alignment is also a factor in the investments that many Alternative Asset Managers are making into insurance companies themselves. In that connection, private equity's business model is predicated on building value over an extended period, including being attentive to policyholder and other stakeholder interests.<sup>3</sup> AIC members who work with insurance companies share insurance regulators' commitment to the long-term health of insurance companies. Private equity firms recognize the reputational aspects that may be attributed to private equity managers as they seek new opportunities. They also understand that insurance company valuations at exit depend on the long-term viability and health of insurance platforms and therefore are dis-incented from extracting short-term returns prior to exit.

---

<sup>2</sup> *Future of Alternatives 2025* report (Preqin, 2021), available at <https://www.preqin.com/insights/research/reports/preqin-special-report-the-future-of-alternatives-2025>

<sup>3</sup> According to AM Best, "private equity firms also have infused considerable amounts of capital to spur rapid growth—a strategy that insurers do not typically execute well. In the first year of private equity ownership, 38% of companies reported increases of over 20% in capital and surplus, rising to 43% in year No. 2 and 50% in year No. 3," available at <https://news.ambest.com/presscontent.aspx?refnum=30878&altsrc=9>.

Private equity and private credit have a successful history of providing capital to, and managing the assets of, the U.S. insurance industry and have played a critical role in supporting that industry and insurance policyholders. Private equity has consistently outperformed traditional asset classes—such as publicly traded stocks and public mutual funds—for the past 40 plus years, including for insurance companies that make up approximately 12% of the invested capital in private equity funds.<sup>4</sup> While some have raised a concern that illiquid or alternative assets present increased illiquidity or other risks, studies show that illiquid or alternative assets reduce risk for a given level of return.<sup>5</sup> Further, while this outperformance inures to the benefit of policyholders, most of the insurance balance sheet assets managed by Alternative Asset Managers actually involve debt securities, most of which securities are investment grade or their equivalents. These securities enable insurance companies to achieve attractive risk-adjusted yields versus public debt investments. Consistent with applicable state laws and regulations, investments in private equity make up a relatively small portion of insurance balance sheets.

In addition, Alternative Asset Managers have long-term incentives and are subject to significant regulation. Private fund advisers are registered as investment advisers under the Investment Advisers Act of 1940 (the “Advisers Act”) with the SEC. The SEC seeks to administer and enforce legal obligations on private fund advisers through an active examination and oversight program, including with an announced focus on conflicts. Insurance companies advised by private fund advisers receive the benefits of this regulatory oversight.

The Task Force’s considerations enunciate potential concerns that activities by private equity firms may present additional conflicts of interest in the context of their insurance-related activities. We believe that insurance regulators already have existing robust regulatory tools available to protect insurance companies, including capital requirements and ongoing examination and supervision. We welcome appropriate study and oversight and believe that regulators will find that the business practices identified, when properly executed, are not per se problematic for any insurance entity (including those affiliated with private equity) and should not be approached with a presumption of heightened risk. We also believe that the most productive areas of study will be on the activities at issue rather than the identity of the owner.

---

<sup>4</sup> *Global Private Equity & Venture Capital Report* (Prequin, 2021) available at <https://www.prequin.com/insights/global-reports/2021-prequin-global-private-equity-and-venture-capital-report>.

<sup>5</sup> National Association of State Retirement Administrators, “NASRA Issue Brief: Public Pension Plan Investment Return Assumptions,” 2015, updated February 2017; Hamilton Lane data via Morgan Stanley Research, “*How Long Will the Golden Age of Private Markets Last?*” February 2021.



Again, the AIC commends the NAIC and the Task Force for seeking to further understand the relationships between Alternative Asset Managers and insurance companies. We stand ready to assist in this regard and would be pleased to answer any questions that you might have concerning the issues expressed in this letter.

Respectfully submitted,

A handwritten signature in blue ink that reads "Jason Mulvihill". The signature is written in a cursive style with a large, sweeping initial "J".

Jason Mulvihill  
Chief Operating Officer & General Counsel  
American Investment Council

January 18, 2022

Justin Schrader  
Chief Examiner, Nebraska Insurance Department

Todd Sells  
Director, Financial Regulatory Policy & Data

Tim Nauheimer  
Sr. Financial Markets Advisor – Macroprudential Surveillance

**Re: Comments Regarding NAIC Macroprudential (E) Working Group exposed “Regulatory Considerations Applicable (but not exclusive to) Private Equity Owned Insurers”**

Thank you for the opportunity to provide initial comments regarding the NAIC Financial Stability Task Force (FSTF) and Macroprudential (E) Working Group (MWG) exposure, “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers” (hereafter, “Regulatory Considerations”).

ACLI supports efforts to ensure that the insurance regulatory framework provides robust consumer protection and safeguards; and fosters the life insurance industry’s ability to provide financial protection, promote financial security, and fulfil its long-term promises to consumers. This is vital because Americans often entrust their financial protection and retirement security to a life insurer. Consumers should have confidence in a life insurers’ ability to fulfill its promises. That confidence starts with a robust regulatory framework and tools that allow regulators to address risks appropriately, regardless of their source.

ACLI recognizes that regulators interest in these topics may emanate, at least in part, from the evolution in the life insurance industry and markets over the past decade, including the expanded involvement of alternative asset managers, such as private equity firms, in the life insurance industry. ACLI supports regulators efforts to periodically evaluate areas of concern as the industry and markets evolve and to promptly and appropriately address any issues that are identified. As such, ACLI supports the FSTF’s recommendation to conduct a gap analysis of the existing regulatory framework to ensure that appropriate tools and disclosures are in place to (1) protect and inform consumers and (2) allow regulators to assess and appropriately address any attendant risks that may arise over time.

As the NAIC and MWG undertakes this work, we offer these high-level observations for your consideration:

- **Focus on the activities and how the regulatory system addresses and oversees any associated risks.** While transparency into ownership matters, ACLI believes the regulators should generally focus on activities, including the (i) activities performed, (ii) management of those activities and associated risks, and (iii) appropriate regulatory oversight of those risks. Focusing on risks of activities rather than specific corporate structures will allow regulators to effectively supervise insurers and protect consumers now and in the future, as the industry continues to evolve.

- **Determine if regulators have the right tools and whether they are being properly leveraged to address an evolving market.** ACLI supports efforts to perform a regulatory gap analysis to determine whether regulators possess the right tools to preserve long-term, financial stability in an evolving market. To the extent that an analysis determines that enhanced tools are needed, ACLI supports prioritizing efforts that will focus on enhancing existing tools, first.
- **Central coordination of the gap analysis and related initiatives is a sensible approach.** ACLI supports the FSTF's decision to affirm the role of the MWG as the coordinator of the "Regulatory Considerations" gap analysis and any related initiatives that may emerge. We recommend that the FSTF and the MWG consider clearly articulating the regulatory concern(s) underlying this initiative. A concise statement of the overarching objectives and concerns may keep the focus on the key underlying issues so that regulators can focus on the issues they deem most critical before addressing other issues. New regulatory initiatives, if needed, should be narrowly tailored to address a clearly defined risk. The slide deck distributed for the September 30, 2021, meeting of the FSTF may provide a good place to start.
- **Additional information.** Although the exposure provides some helpful background information, we expect additional information regarding certain considerations will be needed to enable regulators to work appropriately to identify and address any necessary improvements to our existing regulatory framework. Additional information and details regarding disclosures (#2), conflicts of interest (#7) and captives and side car vehicles (#13) would be especially helpful.

The ACLI has provided preliminary responses to selected "Regulatory Considerations" using the points described above as guidance. Those answers are in the enclosed appendix. We look forward to working with regulators on these important issues.

Sincerely,



Mariana Gomez-Vock



David Leifer



Gabrielle Griffith

Cc: Kristin Abbott, Shelby Schoensee

## Appendix 1. ACLI preliminary responses to Regulatory Considerations

### *Consideration #1*

“Regulators may not be obtaining clear pictures of risk due to holding companies structuring contractual agreements in a manner to avoid regulatory disclosures and requirements. Additionally, affiliated/related party agreements impacting the insurer’s risks may be structured to avoid disclosure (for example, by not including the insurer as a party to the agreement).”

Although ACLI notes that focusing on activities and risks is key, ACLI supports transparency into affiliate relationships. ACLI looks forward to working with regulators to address any potential issues identified during the gap analysis. If changes are needed to promote additional transparency within existing regulatory tools, the ACLI would welcome the opportunity to provide input during the vetting process.

### *Consideration #2*

“Control is presumed to exist where ownership is  $\geq 10\%$ , but control considerations may exist with less than 10% ownership. For example, a party may exercise a controlling influence over an insurer through Board and management representation or contractual arrangements, including non-customary minority shareholder rights or covenants, investment management agreement (IMA) provisions such as onerous or costly IMA termination provisions, or excessive control or discretion given over the investment strategy and its implementation.”

As noted in our comment letter, initiatives should focus on activities that may constitute control even in absence of board representation and share ownership.

It may be helpful to distinguish ownership from asset-management services when assessing controls and conflicts, especially if  $< 10\%$  of ownership is present and only an asset-management services agreement is at issue.

Clarification, and greater predictability, however, may be needed regarding determinations of “control”, especially where less than 10% ownership is present and other traditional indications of control are absent, and the only issue is an asset management services agreement. It may be helpful to distinguish ownership from asset-management services when controls and conflicts are assessed.

### *Consideration #4*

“Owners of insurers may be focused on short-term results which may not be in alignment with the long-term nature of liabilities in life products. For example, excessive investment management fees paid to an affiliate of the owner of an insurer may effectively act as a form of unauthorized dividend in addition to reducing the insurer’s overall investment returns. Similarly, owners of insurers may not be willing to transfer capital to a troubled insurer.”

We encourage regulators to view ownership in a balanced way. As noted above, ACLI recommends that regulators focus on activities and associated risks, rather than specific corporate structures as they evaluate potential “short-termism” risk.

It is not clear to ACLI that all firms with certain ownership structures are inherently different than other types of owners in their willingness to transfer or raise capital for, a troubled insurer. Focusing on activities (e.g., management fees, the length of holding periods for investments, etc.) and associated risks may provide greater clarity on whether an insurer or its owners are prioritizing short-term results over long-term results.

As regulators evaluate this consideration, they should also consider the existing tools that assess the capitalization, liquidity, and overall financial strength of regulated insurers, as well as existing disclosures of management agreements and associated fees.

#### ***Consideration #5***

“Operational, governance and market conduct practices being impacted by the different priorities and level of insurance experience possessed by entrants into the insurance market without prior insurance experience, including, but not limited to, PE owners. For example, a reliance on TPAs due to the acquiring firm’s lack of expertise may not be sufficient to administer the business. Such practices could lead to lapse, early surrender, and/or exchanges of contracts with in-the-money guarantees and other important policyholder coverage and benefits.”

ACLI encourages this ongoing regulatory focus on insurers managerial experience as companies enter new lines of business or are acquired (and thereafter), including management’s ability with respect to operations, governance, market conduct and the oversight of TPAs, as well as investment and risk management experience. ACLI notes that the use of TPA’s is fairly common in the industry and should not, alone, constitute a sign of insufficient experience.

#### ***Consideration #6***

“No uniform or widely accepted definition of PE and challenges in maintaining a complete list of insurers’ material relationships with PE firms. (UCAA (National Treatment WG) dealt with some items related to PE.) This definition may not be required as the considerations included in this document are applicable across insurance ownership types.”

We concur that trying to fix a definition of PE is likely to be unproductive. It seems preferable to focus on an activities-based approach and the utility of regulatory tools to provide desired insights into risk, regardless of the source(s) of capital.

#### ***Consideration #7***

“The lack of identification of related party-originated investments (including structured securities). For example, this may create potential conflicts of interests and excessive and/or hidden fees in the portfolio structure. Assets created and managed by affiliates may include fees at different

levels of the value chain. Regulatory disclosures may be required to identify underlying related party/affiliated investments and/or collateral within structured security investments (An agenda item and blanks proposal are being developed by SAPWG.)”

**Regarding Transparency.** Affiliate relationships should be transparent and disclosed to regulators. We support the consideration of how to leverage existing tools (at the granular and enterprise levels) to make affiliate relationships more transparent, including:

- Schedule Y disclosures
- GAAP and statutory related party footnotes
- Disclosure through holding company filings and to regulators about overall affiliate positions and practices
- Regular dialogue with domestic regulators, including through the course of regulatory examinations, regarding transactions and overall practices,

**Regarding Conflicts:** All insurers need to be vigilant in risk management on conflicts of interest, and governance and oversight mechanisms need to be suitable and flexible while adjusting as business practices change. We encourage regulators to identify specific issues in this area to foster additional discussion on the topic, and in the interim insurers should take appropriate steps to manage or avoid any conflicts arising from affiliate relationships.

#### ***Consideration #8***

“Though the blanks include affiliated investment disclosures, it is not easy to identify underlying affiliated investments and/or collateral within structured security investments.”

We recommend combining #7 and #8.

#### ***Consideration #9***

“Broader considerations exist around asset manager affiliates (not just PE owners) and disclaimers of affiliation avoiding current affiliate investment disclosures. (A new Sc Y, Pt 3, has been adopted and will be in effect for year-end 2021. This schedule will identify all entities with greater than 10% ownership – regardless of any disclaimer of affiliation - and whether there is a disclaimer of control/disclaimer of affiliation. It will also identify the ultimate controlling party. Additionally, SAPWG is developing a proposal to revamp Schedule D reporting, with primary concepts to determine what reflects a qualifying bond and to identify different types of investments more clearly, including asset-backed securities.)”

Before taking additional steps, it will be helpful to first evaluate whether the new Schedule Y, Part 3 and the revamped Schedule D report provide regulators with the additional necessary information they are seeking. ACLI looks forward to continued engagement on this initiative.

#### ***Consideration #10***

“The material increases in privately structured securities (both by affiliated and non-affiliated asset managers), which introduce other sources of risk or increase traditional credit risk, such as complexity risk and illiquidity risk, and involve a lack of transparency. *(The NAIC Capital Markets Bureau continues to monitor this and issue regular reports, but much of the work is complex and time-intensive with a lot of manual research required. The NAIC Securities Valuation Office will*

*begin receiving private rating rationale reports in 2022; these will offer some transparency into these private securities.)”*

The analysis of privately structured securities should be evidence-based, and risk-based. ACLI is also committed to transparency and is willing to help facilitate regulator understanding and oversight.

We also appreciate the additional transparency provided by the new SVO reports and are willing to help facilitate added transparency.

### ***Consideration #11***

“The level of reliance on rating agency ratings and their appropriateness for regulatory purposes (e.g., accuracy, consistency, comparability, applicability, interchangeability, and transparency). (VOSTF has previously addressed and will continue to address this issue.)”

We support a pragmatic approach to establishing an analytical framework for reliance on NRSROs for capital charges in the RBC framework. It’s important to note that from time-to-time NRSROs have different subject matter expertise in a particular asset class (or even an inability to rate some securities), bandwidth and other operational and financial considerations.

### ***Consideration #12***

“The trend of life insurers in pension risk transfer (PRT) business and supporting such business with the more complex investments outlined above (LATF has exposed questions aimed at determining if an Actuarial Guideline is needed to achieve a primary goal of ensuring claims-paying ability even if the complex assets (often private equity-related) did not perform as the company expects, and a secondary goal to require stress testing and best practices related to valuation of non-publicly traded assets. Additionally, enhanced reporting in 2021 Separate Accounts blank will specifically identify assets backing PRT liabilities.) Considerations have also been raised regarding the RBC treatment of PRT business.

- a. Review applicability of Department of Labor protections resulting for pension beneficiaries in a PRT transaction.
- b. Review state guaranty associations’ coverage for group annuity certificate holders (pension beneficiaries) in receivership compared to Pension Benefit Guaranty Corporation (PBGC) protection.”

We recommend the NAIC committees of jurisdiction (e.g., Risk-Based Capital Investment Risk and Evaluation Working Group, Life Actuarial Task Force) evaluate those concerns related to investment risk, including whether the insurance regulatory framework appropriately reflects the associated investment risks.

### ***Consideration #13***

“Insurers’ use of offshore reinsurers (including captives) and complex affiliated sidecar vehicles to maximize capital efficiency and introduce complexities into the group structure.”

The NAIC has enacted reforms relative to offshore reinsurers and captives in recent years. Additional background on this aspect of Regulatory Consideration #13 is needed.

With respect to sidecars, we agree that regulators should understand these vehicles and their risks within the group structure, while also recognizing how sidecars support the ability of insurers to attract capital to support policyholder obligations and benefits. ACLI encourages the MWG or FSTF to provide additional specificity regarding regulatory considerations associated with the use of affiliated sidecar vehicles.





National Organization of Life and Health Insurance Guaranty Associations

13873 Park Center Road, Suite 329 | Herndon, VA 20171

Phone: 703.481.5206 | Fax: 703.481.5209

www.nolhga.com

January 18, 2022

Todd Sells  
Director, Financial Regulatory Policy & Data  
National Association of Insurance Commissioners  
2301 McGee Street, Suite 800  
Kansas City, Missouri 64108-2604

Re: Regulatory Considerations Relating to Private Equity Owned Insurers

Dear Mr. Sells:

Thank you for the opportunity to provide comments on the document entitled “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers” (the “Considerations Document”). This letter is being submitted on behalf of the National Organization of Life and Health Insurance Guaranty Associations (“NOLHGA”).

We write to advise you that NOLHGA has conducted work relating to item 12b of the Considerations Document – “Review state guaranty associations’ coverage for group annuity certificate holders (pension beneficiaries) in receivership compared to Pension Benefit Guaranty Corporation (PBGC) protection”. In 2016, NOLHGA produced a report on this topic entitled “Consumer Protection Comparison – The Federal Pension System and the State Insurance System”. A copy of the report is enclosed for your information.

We would be pleased to answer any questions on the report, and to otherwise work with the Financial Stability Task Force (or other relevant NAIC group) as a resource on this topic.

Sincerely,

The National Organization of Life & Health  
Insurance Guaranty Associations

A handwritten signature in black ink that reads "Peter G. Gallanis". The signature is written in a cursive style with a large initial "P".

Peter G. Gallanis  
President

# **CONSUMER PROTECTION COMPARISON**

**The Federal Pension System and the State Insurance System**



May 22, 2016



---

# **CONSUMER PROTECTION COMPARISON**

## **The Federal Pension System and the State Insurance System**

**May 22, 2016**

A report from the National Organization of Life and Health Insurance Guaranty Associations  
with substantial contributions from Faegre Baker Daniels





---

# Table of Contents

<b>Introduction</b> .....	<b>2</b>
<b>Executive Summary</b> .....	<b>4</b>
<b>ONE: A Brief Overview of the Two Consumer Protection Systems</b> .....	<b>6</b>
The Pension Protection System .....	6
The Insurance Protection System .....	7
The Special Status of Insurance under ERISA .....	9
<b>TWO: How the Systems Protect Payer Solvency</b> .....	<b>12</b>
Insolvency Prevention in the Pension System .....	12
Private pension funding sources .....	12
Pension solvency-regulation mechanisms .....	13
Pension plan failure experience .....	14
Current pension plan financial health .....	14
Insolvency Prevention in the Insurance System .....	15
Private insurance funding sources .....	15
Insurance solvency-regulation mechanisms .....	16
Insurance company failure experience .....	18
Current insurance company financial health .....	18
Summary of Insolvency Prevention in the Two Systems .....	19
<b>THREE: How the Systems Protect Benefits After Payer Insolvency</b> .....	<b>20</b>
The PBGC Safety Net for Failed Pension Plans .....	20
PBGC pension guaranty and federal priority formulas .....	20
Actual pension benefit loss experience .....	21
The Guaranty Association Safety Net for Failed Insurance Companies .....	21
Insurance guaranty and priority formulas .....	21
Actual insurance benefit loss experience .....	24
Summary of Post-Insolvency Protections in the Two Systems .....	25
Willis Towers Watson Study .....	26
<b>Conclusion</b> .....	<b>38</b>
<b>Appendix: Individual Protection Examples</b> .....	<b>A-1</b>
Plan-Level Assumptions .....	A-1
An Example in Detail .....	A-2
Summary of All Examples .....	A-5
Individual 1 .....	A-5
Individual 2 .....	A-7
Individual 3 .....	A-10
<b>End Notes</b> .....	<b>B-1</b>

# Introduction

**T**he life insurance industry has played a major role in employer-based pension plans for nearly a century. Insurers helped spur the growth of pension plans by issuing group annuity contracts to employers, and federal pension regulation has carved out a special role for insurance companies, in recognition of their risk-spreading capabilities and their close oversight by state regulators.

In the most recent manifestation of pension-insurance interaction, some defined benefit pension plans—particularly those sponsored by large, publicly traded companies—have purchased group annuity contracts to transfer to insurance companies the plan-promised benefit obligations for categories of participants. By implementing such “de-risking” strategies, sponsoring employers have attempted both to reduce financial volatility and other risks and expenses associated with managing plan assets and liabilities, and to take advantage of the expertise the insurance industry has developed in its core business of matching assets to liabilities to deliver long-term annuity benefits. Through such annuity purchases, pension plans do not avoid the costs of paying for earned pension benefits; instead, they pre-pay those costs, in the form of annuity premiums equal to the full economic value of the earned benefits for affected participants.<sup>1</sup>

This report reviews in detail the array of protections provided both for participants in defined benefit plans and former plan participants who come to be protected by annuities issued in pension de-risking transactions. An objective comparison of those protections—which are delivered through two different protection systems that have similar objectives but are very

different in application—compels the conclusion that participants are strongly protected in both cases: the resolution and safety net mechanisms of the two systems would fully cover the vast majority of all benefit claims, and the small minority of benefit claims not fully covered would have marginally different outcomes, sometimes slightly favoring one system or the other for some individuals, depending on the specific circumstances of a particular case.

Some de-risking transactions have employed voluntary lump-sum “window” programs. These programs, which have been offered on a stand-alone basis or in combination with annuity-purchase transactions, have typically offered categories of participants the option, for a limited time period, to elect to receive their pension benefits as lump-sum payments. Concerns about lump-sum window programs have been raised in many quarters, in part because window programs offer participants the opportunity for large, one-time payments, while shifting the burdens of investment, longevity, and other financial risks to participants who may have difficulty managing them.<sup>2</sup> With annuity-purchase approaches to de-risking, by contrast, participants continue to receive the same forms of benefit provided under their plans, and the investment, longevity, and other financial risks are borne by highly regulated insurance companies.<sup>3</sup>

In most respects, today’s annuity-purchase de-risking transactions are familiar, with the same legal and financial characteristics as annuity-purchase arrangements that federal law has long mandated for terminating defined benefit plans. But current de-risking trends have nevertheless focused attention on one consequence

of de-risking—the transfer of benefit-protection responsibilities for lifetime pension/annuity benefits from the pension system to the insurance system.<sup>4</sup>

Private-sector pension benefits are primarily protected by a 40-year-old federal regulatory system, while group annuity benefits are protected by a somewhat older state regulatory system. Both systems have evolved over time. The two comprehensive benefit-protection systems share many general objectives and attributes, but differ in important details. The federal pension system and the state insurance system protect consumers against the risk of non-payment of benefits in significantly different ways. Any comparison of the two systems that focuses only on the nominal benefit levels guaranteed by the two systems' vastly different safety nets is inadequate and misleading. A valid comparison of the protection systems requires a broader comparison of two vital elements of each system: (1) the regulatory controls designed to ensure payment of all promised benefits by preventing the insolvency of the private benefit payer (whether an employer-sponsored pension plan or a life insurance company that issues annuities); and (2) the post-insolvency safety net mechanisms, particularly the operations of their guaranty formulas and the extent to which consumers may recover from the insolvent plan's or insurer's remaining assets for claims exceeding guaranteed amounts.<sup>5</sup>

To help explain the two elements and compare the two benefit-protection systems, the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA), with substantial assistance from the law firm Faegre Baker Daniels and

actuarial consultants at Willis Towers Watson, has undertaken a qualitative and quantitative comparison of the consumer protections afforded to participants under pension plans<sup>6</sup> and protections that are provided to payees under annuities issued by life insurance companies (sometimes referred to herein, respectively, as “plan participants” and “annuitants” or “annuity payees”).



# Executive Summary

**W**hen an employer de-risks its pension plan by purchasing one or more annuity contracts, consumer protections for affected individuals shift from the pension system to the insurance system. From a consumer-protection perspective, how does that shift affect the relative levels of protection? As this report summarizes, the two systems employ different methods of protections that have different features and formulas, but both provide strong, time-tested protection of future pension or annuity benefit payments. One fact clearly emerges from the qualitative and quantitative analysis described in this report: to obtain an accurate understanding of the two systems' consumer-protection differences, it is wholly inadequate and misleading to look only at the nominal guaranty levels of the Pension Benefit Guaranty Corporation and the state guaranty associations.

The systems provide consumer protection in two important ways: first, by protecting against the failure of the entity obligated to make the benefit payments; and second, by providing protections to the benefit recipients if the entity fails.

Since consumers rely on the pension plan or annuity issuer to make ongoing benefit payments, both systems have established financial standards and regulatory bodies to protect the solvency of the plan or insurer. The pension system, principally through the federal Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code, sets funding and other requirements for about 22,000 single-employer defined benefit pension plans, and it authorizes the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation (PBGC) to administer and enforce those requirements. The

insurance system, operating through a national network of state insurance laws coordinated through the National Association of Insurance Commissioners (NAIC), establishes reserve, investment, and other financial standards for the approximately 460 life insurance companies that issue annuity policies today, and it empowers insurance regulators to enforce those standards.

Even though both systems focus on payer solvency, insurance regulation generally holds life insurance companies to stricter financial standards and more intensive oversight than are applied by pension regulation to single-employer pension plans. As one significant difference, although ERISA places the ultimate funding responsibility on a pension plan's sponsoring employer, ERISA gives pension regulators no control over the financial condition of the sponsoring employer. Pension plan funding is often, but not always, consistent with the plan sponsor's financial condition, and for some purposes pension plan funding levels may fall to as low as 80% of plan liabilities before triggering certain adverse consequences under federal law.<sup>7</sup> ERISA plan sponsors are not meaningfully regulated for solvency, whereas constant solvency regulation is the primary focus of insurance regulation.

The relative intensity of the regulatory systems is reflected in the comparative failure rates of pension plans and annuity issuers. Since the 2008 financial crisis, no active issuer of annuity contracts with remaining annuity obligations failed, while pension plan failures have claimed a total of 931 single employer plans covering more than 560,000 participants. Historically, when annuity issuers have failed, they have also typically closed with substantially higher funded ratios (of assets to liabilities) than the compa-

rable funded ratios for failed pension plans—76% for annuity issuers and 52% for pension plans.<sup>8</sup>

In the second element of consumer protection—if and when a pension plan or annuity issuer fails—affected consumers must rely on the failure resolution processes and on the financial safety nets provided under each of the two systems. In the pension system, the PBGC guarantees pension benefits, within statutory limits. The PBGC receives its funding from insurance premiums charged to active pension plans, investment income, the assets of insolvent plans it takes over, and some additional recoveries against plan sponsors. It receives no direct funding from general tax revenues, and its obligations are not backed by the full faith and credit of the United States.<sup>9</sup> In the insurance system, each state has created a guaranty association (GA) under state law to protect annuity and life insurance benefits for its residents (within statutory limits) as part of a comprehensive insolvency process for failed insurers that allocates a failed insurer’s remaining assets to the GAs and to the policyholders (for benefits not covered by the GAs) as priority creditors on the same priority level. The GAs receive funding from assessments against licensed insurers, a proportional share of the assets of failed life insurance companies, and other private sources. Like the PBGC, the GAs are not directly funded by tax dollars and are not backed by any state’s full faith and credit.<sup>10</sup>

The safety net mechanisms differ in significant respects from system to system, and direct comparisons are difficult. In the pension system, for example, the PBGC generally uses a higher maximum guaranty level than most GAs provide. On the other hand, in the insurance system many annuity holders receive, *in addition* to the GA’s guaranteed payments, benefits above the guaranty level backed by more assets from the failed insurance company than what is typically available to plan participants from the assets of failed pension plans. On balance, as reflected in a recent quantitative analysis by Willis Towers Watson commissioned by NOLHGA,<sup>11</sup> both

systems provide strong safety nets that cover the vast majority of all benefit claims. Because the two systems use such fundamentally different approaches, for the small minority of benefit claims not fully covered, each system offers at least marginally stronger protections for some individuals than the counterpart system offers under certain factual circumstances.

The Willis Towers Watson Study concludes that both systems would protect the vast majority of participants for 100% of their benefit payments. It also concludes that both systems would protect over 90% of aggregate benefits if the plan or annuity issuer has a funded ratio (of assets to liabilities) of at least 75%. Where the funded ratio is lower, the PBGC safety net generally provides higher levels of protection under some circumstances—particularly if the pension plan’s benefit levels do not exceed PBGC guaranty limits and have not been increased by recent plan amendments. By contrast, the insurance safety net generally provides higher levels of protection under other circumstances—for instance when (a) benefits exceed PBGC guaranty levels, (b) recent plan amendments have increased benefit levels, or (c) funded ratios are relatively high. While the Willis Towers Watson Study compares the two systems at equal funded ratios at the time of failure, there is little evidence to suggest that failed insurers issuing pension de-risking annuities under the modern insurance regulatory system would have funded ratios of 75% or lower, which occurs routinely in pension plan failures.

Both the pension system and the insurance system provide strong protections for their consumers’ benefits. This conclusion is a consequence of the combined effects of each system’s two protection components—first, protecting the solvency of pension or annuity payers; and second, providing an effective resolution process and safety net if and when the payer becomes insolvent and requires resolution.

# ONE

## A Brief Overview of the Two Consumer Protection Systems

### THE PENSION PROTECTION SYSTEM

**P**riate-sector, employer-sponsored pension plans first appeared in the United States in the late 19th Century and developed over time for various reasons, in particular responding to tax advantages that came to be provided under federal tax law.<sup>12</sup> The modern pension regulatory system, however, began four decades ago with the enactment of the federal Employee Retirement Income Security Act of 1974 (ERISA).<sup>13</sup> Congress enacted ERISA primarily to address high-profile cases of lost pension benefits—some caused by employer-initiated cutbacks of promised benefits, and some by employer financial failures.<sup>14</sup> In response, Congress created a complex federal regulatory system for private-sector pension plans, dividing regulatory responsibility among the Treasury Department’s Internal Revenue Service (IRS), the Department of Labor (DOL), and the newly created Pension Benefit Guaranty Corporation (PBGC).<sup>15</sup>

Although ERISA protects benefits promised under pension plans, ERISA does not require that employers adopt defined benefit pension plans or any other types of retirement plan. Even for those employers who adopt pension plans, ERISA allows them to terminate their plans so long as they provide for benefits already earned (or are in financial distress) and meet other statutory requirements.<sup>16</sup> An employer’s decisions to establish and to continue maintaining a pension plan are entirely voluntary, and the prevalence of pension plans has decreased materially over time. In the past two decades, for example, the number of single-employer pension plans in the PBGC system has decreased from more than 53,500 plans (in 1995) to about 22,000 (in 2015), and covered participant counts have decreased

from almost 20% of the private-sector workforce to approximately 10% of that workforce.<sup>17</sup>

In creating the ERISA structure, Congress made private pension regulation a federal domain by preempting virtually all state laws that affect ERISA-covered plans. Congress did, however, recognize that states would continue their long-standing regulation of the business of insurance<sup>18</sup>—an important exception given the insurance industry’s traditional role in the development and delivery of pension benefit programs.

Under the federal regulatory system, the DOL and the IRS enforce a range of ERISA requirements intended to protect pension plan participants, but the PBGC has the primary responsibility for insuring participants against private-sector pension plan insolvency. Formed within the DOL as an independent federal corporation, the PBGC is governed by a Board of Directors whose members are the Secretary of Labor, the Secretary of the Treasury, and the Secretary of Commerce.<sup>19</sup>

The PBGC operates two separately funded insurance programs for private-sector defined benefit plans—one for multiemployer plans (co-sponsored by unions and employers) and another for single-employer plans (each sponsored by one employer and its corporate affiliates). The PBGC insurance program for single-employer plans, which is the main subject of this summary, is funded primarily through three distinct sources: (1) two-part annual premiums paid by active pension plans, (2) assets assumed from underfunded terminated plans, and (3) investment earnings.<sup>20</sup> In recent years, Congress has increased both parts of PBGC premiums—from

\$35 per participant plus 0.9% of any unfunded liability (in 2012) to \$80 per participant plus 4.1% of unfunded liability (to take full effect by 2019).<sup>21</sup> The programs do not receive funding from general tax revenues, and their obligations are not backed by the full faith and credit of the United States.<sup>22</sup>

PBGC funding resources have been significantly strained in recent years. The multiemployer program's financing has been particularly challenged, with the PBGC projecting as recently as 2014 that "the multiemployer program is highly likely to run out of money within a decade."<sup>23</sup> As part of the Multiemployer Pension Reform Act of 2014, Congress relieved some pressure on the program by providing funding relief for multiemployer pension plans, including allowing distressed plans to reduce promised benefits.<sup>24</sup> The single-employer program, while less distressed, is operating at significant deficits and has been affected by a declining base of pension plans. At the end of its Fiscal Year 2015, the PBGC's single-employer program covered fewer than 30 million participants in about 22,000 active pension plans. The single-employer program then had liabilities from previously terminated plans of \$109.8 billion, assets of \$85.7 billion, and a deficit of \$24.1 billion.<sup>25</sup> By comparison, at the end of Fiscal Year 2008, the program covered almost 34 million participants in about 28,000

plans and had liabilities of \$72.3 billion, assets of \$61.6 billion, and a deficit of \$10.7 billion.<sup>26</sup> In the Multiemployer Pension Reform Act, Congress did not extend to single-employer pension plans the power to reduce promised benefits.

## THE INSURANCE PROTECTION SYSTEM

The regulation of insurance and the protection of insurance consumers have been part of the United States legal landscape since 1851, when New Hampshire appointed the first insurance commissioner in the country.<sup>27</sup> Although the federal government comprehensively regulates many other financial sectors, states have long had the primary responsibility for regulating insurance companies and protecting their customers. The U.S. Supreme Court held 70 years ago that Congress has constitutional authority to regulate insurance, but shortly thereafter Congress enacted the McCarran-Ferguson Act of 1945, reserving to the states the primary responsibility for regulating the business of insurance, except to the extent Congress enacts statutes specifically applicable to insurance.<sup>28</sup> The U.S. Supreme Court has ruled that the authority reserved to the states under the McCarran-Ferguson Act extends to the regulation of insurers from cradle to grave, limited only where state law conflicts with federal law specific to insurance.<sup>29</sup>

**Under the federal regulatory system, the DOL and the IRS enforce a range of ERISA requirements intended to protect pension plan participants, but the PBGC has the primary responsibility for insuring participants against private-sector pension plan insolvency.**

A series of insurer insolvencies in the late 1980s, in some cases resulting from speculative investment practices, brought about a significant strengthening of insurer solvency regulation in the early 1990s by state insurance commissioners, acting through the National Association of Insurance Commissioners (NAIC). The NAIC was created in 1871 to coordinate regulation of multistate insurers.<sup>30</sup> Those regulatory changes included the development of risk-based capital requirements, two NAIC receivership model acts, new NAIC model laws regarding insurer investment practices, the codification of statutory accounting, new audit requirements, and the NAIC's state insurance department accreditation system, which is designed to ensure uniformity of important aspects of solvency regulation.

Each state's insurance commissioner has the primary responsibility for regulating the solvency of insurers incorporated in that state (commonly described as the "state of domicile" or the "domestic state"). That regulatory oversight is accomplished through a substantially uniform framework of frequent and detailed financial reporting obligations and rigorous financial restrictions developed through the NAIC, including limitations on the types and concentrations of assets insurers are permitted to hold and conservative standards for valuing those assets and future insurance liabilities.

Each state's review of its domestic insurers is effectively peer reviewed through the NAIC by

the insurance commissioners of the other states where the insurers are licensed. The NAIC structure produces a series of checks and balances in the financial oversight of life insurers. In particular, nationally significant insurers and groups that exhibit characteristics of trending toward financial trouble are reviewed regularly on a coordinated, multistate basis by the NAIC's Financial Analysis Working Group (FAWG), a standing body made up of experienced senior financial regulators from multiple states.<sup>31</sup>

If a potential financial issue is uncovered by the insurer's domestic department of insurance or through FAWG's review, the domestic commissioner has broad statutory authority to intervene directly in the insurer's business and require that a corrective plan be developed and implemented to remove the cause of the financial concern. If corrective actions do not or cannot remediate the problems, the domestic commissioner has the authority to seek a court-supervised receivership in which the commissioner serves, under state law, as court-appointed receiver for the financially impaired insurance company.<sup>32</sup> In that capacity, the commissioner assumes full control of the insolvent insurer and retains any necessary independent experts to evaluate the insurer's condition. The receiver determines whether the insurer's financial issues can be addressed in a way that will permit the insurer to return to business and private management, or whether the problems require that the insurer be liquidated.

**The U.S. Supreme Court has ruled that the authority reserved to the states under the McCarran-Ferguson Act extends to the regulation of insurers from cradle to grave, limited only where state law conflicts with federal law specific to insurance.**

In the worst-case financial situation, the receiver may seek a court order declaring the insurer insolvent and ordering it to be liquidated. Such an order “triggers” the GAs, obligating and empowering them to protect their state residents up to statutorily specified benefit levels.

The national network of GAs began to take shape in 1971. Before 1971, only two states (New York and Wisconsin) had enacted guaranty mechanisms for insurance consumers. In 1971 the NAIC adopted the first model life, health, and annuity guaranty association act.<sup>33</sup> By 1991, every state legislature had created a GA to protect its life, health, and annuity policyholders against insurer insolvency.<sup>34</sup>

While a court order of liquidation is necessary to trigger GA payment obligations, the GAs and the insurance commissioner/receiver typically begin to coordinate efforts much earlier in troubled insurer situations, often before any receivership proceeding is commenced.<sup>35</sup> For life insurers licensed in multiple states, that cooperation generally occurs between the domiciliary regulator (and any “special deputy receiver” the regulator may have designated to act on the regulator’s behalf) and NOLHGA. The GAs formed NOLHGA in 1983 to provide a process, facilities, and staff to coordinate and support the activities of the member GAs, particularly in connection with the insolvencies of insurers writing business in multiple states.<sup>36</sup>

If an insurer liquidation occurs, each affected GA obtains funds to meet its guaranty obligations through two primary sources. First, to the extent GAs are liable for the financial risks that otherwise would be borne by policyholders, the GAs stand on equal footing with the insolvent insurer’s policyholders as priority claimants to the insurer’s remaining assets.<sup>37</sup> To the extent that those assets are insufficient to meet GA coverage obligations, each GA may levy assessments against all other life insurers licensed in the state. By statute, each licensed life insurer must become and remain a member of the state’s GA.

If the GA needs funds when one of those member insurers becomes insolvent, it determines the needed amount and assesses it against all of the licensed insurers based on their shares of the premiums in the state, typically over the three years prior to the insolvency. Member insurers are obliged to make prompt payment of those assessments as a condition to continuing to do business in the state.<sup>38</sup> Like the PBGC, each GA’s protections are self-financed, primarily through member assessments and assets of insolvent insurers allocated to the insurance and annuity obligations the GA protects. The GAs do not receive general tax revenue from their states, and their obligations are not backed by their states’ full faith and credit.<sup>39</sup>

The GAs work with the insolvent insurer’s receiver to develop comprehensive resolution plans for the affected policyholders and annuitants. Such resolutions are often accomplished by effecting a transfer of the insolvent insurer’s business to a financially healthy life insurer through an assumption reinsurance transaction, in which the healthy insurer acquires certain policy liabilities and assets supporting those liabilities. In some transactions, the failed insurer’s annuity business will have an additional strategic value to the purchaser, in which case the purchaser will pay additional value for the assumption, usually described as a “ceding fee” or an “enhancement.” Although the form of that payment may vary, it produces additional value that can be used to protect the insolvent insurer’s policyholders and annuitants who have benefits in excess of the GAs’ coverage levels. Assumption reinsurance transactions have been employed in a number of significant insurance receiverships.<sup>40</sup>

### **THE SPECIAL STATUS OF INSURANCE UNDER ERISA**

By the time Congress enacted ERISA, insurance companies had long been quite involved in providing pension benefits. As far back as the 1920s, employer plans often relied upon major insurers to bear pension funding risks through group annuity contracts.<sup>41</sup> When created in the

1970s, the ERISA regulatory system did not supplant the insurance industry's traditional role. In fact, in view of insurers' highly regulated character and unique risk-spreading capabilities, ERISA has accorded insurers special status, including in these respects:

- Even though ERISA prohibits most state laws from affecting ERISA-covered plans, it expressly allows states to regulate insurance, even annuity policies that pay benefits under ERISA-covered pension plans.<sup>42</sup>
- Although ERISA generally requires employers to hold pension plan assets in trust, employers may, instead, safeguard plan assets by paying them directly to an insurance company, either as premiums to purchase policies or as deposits.<sup>43</sup>
- ERISA's required annual reports (on the Form 5500 series) provide simplified reporting and audit requirements for benefit plans funded through insurance.<sup>44</sup>
- While ERISA generally guarantees defined benefit pensions through the PBGC, PBGC guaranties do not apply to pension benefits covered by irrevocable commitments from insurance companies.<sup>45</sup>
- Recently, the Departments of the Treasury and Labor have been looking to the insurance industry as a means to provide lifetime income options under defined contribution plans. The

Departments "are engaged in a joint initiative to encourage the prudent consideration, offering, and use of lifetime income alternatives, including annuities, in retirement plans."<sup>46</sup>

- Of particular relevance to current de-risking initiatives, if a sponsoring employer decides to terminate its pension plan, ERISA's standard termination rules require that the employer provide for future benefit payments by offering to purchase annuity contracts from private insurers.<sup>47</sup> In a standard plan termination or other de-risking transaction, an individual ceases to be a plan "participant" once the individual's "entire benefit rights" are "fully guaranteed by an insurance company," are legally enforceable at the individual's sole choice, and are reflected in a policy or certificate issued to the individual.<sup>48</sup>

One of the most important interactions between the ERISA and insurance worlds occurs when a pension plan purchases an annuity contract to pay benefits, whether as part of a complete de-risking transaction resulting from a full plan termination, or as part of a partial de-risking transaction for one or more subsets of plan participants. In implementing such a purchase, the plan's fiduciaries must comply with the prudence, loyalty, and other statutory duties that ERISA demands of fiduciaries, and by violating those duties, fiduciaries may incur a range of

**Even though ERISA prohibits most state laws from affecting ERISA-covered plans, it expressly allows states to regulate insurance, even annuity policies that pay benefits under ERISA-covered pension plans.**

statutory sanctions, including personal liability. The Department of Labor has issued special guidance for fiduciaries when selecting annuity providers for pension plans, including the central requirement that they “take steps calculated to obtain the safest annuity available, unless under the circumstances it would be in the interests of participants and beneficiaries to do otherwise.” To satisfy that requirement, commonly referred to as the “safest available annuity” standard, fiduciaries are to consider such factors as the insurer’s investment portfolio (including quality and diversification), its size relative to the annuity contract, its capital and surplus, and its business lines and exposure to liability. In addition, the fiduciaries must consider state guaranty association coverage and “the structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts.”<sup>49</sup> Given those obligations, plan fiduciaries often engage independent fiduciaries to implement major annuity-purchase transactions, and they have strong incentives to select the largest and most financially secure insurers.



# TWO

## How the Systems Protect Payer Solvency

In both the pension system and the insurance system, the first line of consumer defense is to assure the financial health of those private entities that have promised to pay benefits. If the government regulatory systems can help prevent the insolvency of those private payers, the consumers will receive all their promised benefits, without having to invoke the backup protections of the resolution and safety net mechanisms.<sup>50</sup>

### INSOLVENCY PREVENTION IN THE PENSION SYSTEM

#### Private pension funding sources

Ongoing pension plans typically have two sources of benefit funding—the plan’s trust assets and the sponsoring employer’s general assets. At the first level, a pension plan normally funds benefits through a trust, a separate legal entity established for the exclusive purpose of paying plan benefits and related expenses. The plan’s sponsoring employer establishes the trust by agreement with a trustee, often a bank or other financial institution. The trust accumulates assets from periodic contributions made by the sponsoring employer (and in some cases by participants) and from investment earnings on those contributions. When participants retire, the trust pays plan benefits from its assets. Trust assets are protected from the sponsoring employer’s insolvency and cannot be reached by the employer’s creditors, nor can they be withdrawn by the employer except in a plan termination after full satisfaction of all benefits.<sup>51</sup>

But trust assets are not always equal to the plan’s benefit liabilities. In a defined benefit plan, benefit formulas (often based on participants’ compensation levels and years of service) dictate the participants’ earned benefit amounts. At

a given time, the trust may be “underfunded,” having trust asset values less than the value of the plan’s promised benefits. Underfunding may occur for a variety of reasons—commonly because contributions have been phased in gradually, investment earnings have been smaller than predicted, benefit liabilities have grown larger (often because of interest rate movements) or become payable more quickly than expected, or a combination of those factors. Moreover, the rules applicable to pension plans do not require a plan to recognize the plan’s full economic liability. For instance, the recognition of future expenses of the plan and a provision for asset defaults are not required to be part of the accounting value for a pension plan, but are required to be included in the reserves an insurance company must establish and fully fund. Nor does ERISA require that trust assets always equal the present value of future liabilities; instead, it generally allows plans to remedy underfunding gradually over several years.

When trust assets do not match plan liabilities, the ERISA system looks to the ultimate source of plan funding—the sponsoring employer and its corporate affiliates.<sup>52</sup> For an underfunded plan that continues to function and pay benefits, ERISA generally requires the sponsoring employer to make contributions that, over time and using various assumptions, are expected to bring the plan to full funding. And for a pension plan that terminates in a “standard termination”—a process managed by plan fiduciaries and service providers (without the PBGC assuming plan assets and payment obligations) through the purchase of an annuity from a licensed life insurance company—ERISA requires the sponsoring employer to make whatever contributions are necessary to fund plan benefits fully.<sup>53</sup>

### **Pension solvency-regulation mechanisms**

In regulating the first level of funding sources—the trust assets—ERISA employs a variety of mechanisms to encourage sound funding. Compared to insurance company regulation, however, the regulatory oversight is less regular, pervasive, and strict. With about 22,000 single-employer pension plans to oversee, the ERISA compliance system relies heavily on plan-level fiduciaries and service providers, with regulators primarily limited to reviewing (to varying degrees) plan reporting, auditing compliance on occasion, and taking aggressive action only after serious financial problems have been clearly identified. ERISA’s primary controls on trust funding include the following:

- *Annual minimum funding requirements.* Federal law establishes an annual contribution requirement, which the IRS may waive in the event of business hardship. Rules for calculating minimum contributions are complex, but they rely on actuarial assumptions (with prescribed interest rates and mortality tables) and offer some contribution-smoothing mechanisms (including seven-year amortization of funding shortfalls). The calculations are done deterministically, and stochastic testing is not required.<sup>54</sup> Funding status can deteriorate rapidly, even if the sponsoring employer has always met its minimum contribution requirements. Pension plans, which are not subject to fixed asset-allocation requirements and often allocate more than 60% of their investments to equities, may experience unexpected asset losses.<sup>55</sup> And they can have unexpected spikes in benefit liabilities, caused by drops in the discount rates used for determining the present value of future benefit liabilities.<sup>56</sup>
- *Benefit restrictions.* If a plan’s funding level falls below certain levels, suspensions are imposed (at various funding thresholds) on certain ancillary benefits, lump sum distributions, benefit improvements, and additional benefit accruals.<sup>57</sup>
- *Fiduciary duties.* Those who exercise discretion and control over plan assets, including invest-

ment decisions, must satisfy fiduciary duties of prudence, loyalty, and diversification, and must comply with ERISA and plan provisions.<sup>58</sup> Those duties are general in nature, however, and focus more on compliance with appropriate procedures than with actual results.

- *Procedural requirements.* Most pension plans must have annual audits, obtain actuarial evaluations, and file various reports with federal agencies.<sup>59</sup>
- *IRS and DOL enforcement.* Both the IRS and the DOL may audit plans to determine compliance with legal requirements and impose a variety of sanctions for violations. The DOL may also bring court actions for injunctive and monetary relief and, in limited situations, criminal sanctions.<sup>60</sup>
- *PBGC enforcement.* The PBGC collects premiums for its insurance coverage, including a variable premium that increases with funding shortfalls, and requires formal notice of certain “reportable events” that may suggest deterioration in plan financial security. If plan funding is sufficiently threatened, the PBGC may initiate an involuntary termination, take over the plan’s assets and benefit payments, and seek to recover any shortfall from the plan sponsor and its affiliates. The PBGC may also file claims and take other litigation action if the sponsoring employer (or an affiliate) goes through bankruptcy proceedings. In advance of taking those formal enforcement actions, the PBGC may also negotiate for funding improvements or other financial security enhancements.<sup>61</sup>
- *Termination procedures.* To terminate a pension plan in a standard termination, the sponsoring employer must obtain special actuarial certifications and provide special reports to employees and regulators. If the plan has insufficient assets, the sponsor must make up the shortfall or abandon the termination process.<sup>62</sup>

In contrast to its regulation of trust funding, ERISA includes no regulatory power at all over a plan’s ultimate funding source—the financial strength of the sponsoring employer and its corporate affili-

ates. As the PBGC recognized in an August 2012 report on plan funding, “the risk of termination of a plan depends most significantly on the plan sponsor’s financial strength, not on its current funding level.”<sup>63</sup> The sponsoring employer and its affiliates are jointly and severally liable for making plan contributions and for covering the plan’s funding shortfall upon plan termination. Despite that reality, the federal pension system contains no mechanisms to control the financial health of sponsoring employers.

**Pension plan failure experience**

The global financial crisis that began in late 2008 and the related “Great Recession” took a toll on the nation’s pension plans. Several hundred plans, covering hundreds of thousands of participants, failed financially, causing PBGC takeovers and triggering PBGC benefit guaranties. As described in the PBGC’s 2009 Annual Report, the “breadth of business failures across sectors and regions in FY 2009 was unprecedented in PBGC’s 35-year experience.” In that year, “PBGC became directly responsible for the pensions of nearly 201,000 new participants, the third-highest annual total in PBGC’s history and about nine

times the 22,000 new participants in plans taken in during FY 2008.”<sup>64</sup>

Table 1 (below), using data drawn from PBGC annual reports, summarizes the underfunded single-employer plans that terminated during the eight most recent PBGC fiscal years (ending September 30 of the listed year).

Note what pension plans are not covered by the above statistics: (1) fully funded single-employer defined benefit plans that terminated in standard terminations; (2) multiemployer plans (also called Taft-Hartley plans), which are covered by a separate PBGC program; (3) defined contribution retirement plans, which are not covered by PBGC insurance; and (4) plans sponsored by governmental entities and most churches, which are not covered by PBGC insurance or by ERISA generally.

**Current pension plan financial health**

Although comprehensive funding data is not readily available for all single-employer, private-sector pension plans, actuarial estimates of large employer plans provide some sense of general

**Table 1. Terminated Single-Employer Plans, 2008–2015**

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
<b>Number of Plan Failures</b>	67	144	147	152	155	111	86	69
<b>Number of Affected Participants</b>	22,000	201,000	99,000	57,000	47,000	57,000	53,000	25,000
<b>Plan Liabilities*</b>	\$662	\$15,692	\$3,130	\$2,363	\$2,035	\$4,246	\$1,928	\$1,912
<b>Plan Assets*</b>	\$391	\$9,860	\$1,688	\$1,173	\$1,027	\$2,367	\$993	\$1,132
<b>Plan Under-funding*</b>	\$271	\$5,832	\$1,442	\$1,190	\$1,008	\$1,879	\$935	\$780
<b>Asset/Liability Ratio</b>	59.1%	62.8%	53.9%	49.6%	50.5%	56.0%	51.5%	59.2%

\* All dollar amounts are expressed in millions. Plan assets do not include a recovery ratio for affected participants, which is typically a small portion of benefits recovered from pension plan sponsors and their corporate affiliates.

**As the PBGC recognized in an August 2012 report on plan funding, “the risk of termination of a plan depends most significantly on the plan sponsor’s financial strength, not on its current funding level.”**

funding levels. As of the end of 2015, Milliman Inc. estimated that the 100 largest corporate pension plans had an average funded ratio of 82.7%, and Mercer LLC estimated the pension funded status for Standard & Poor’s 1500 companies to average 82%.<sup>65</sup> As of December 31, 2015, Willis Towers Watson examined pension plan data for the 413 Fortune 1000 companies that sponsor calendar year plans and estimated an aggregate funded status of 82%.<sup>66</sup>

**INSOLVENCY PREVENTION IN THE INSURANCE SYSTEM**

**Private insurance funding sources**

The payment of annuity benefits depends primarily on the insurer’s assets. Those assets, usually held in the insurer’s general account, come primarily from two sources: (1) premiums charged by the insurer for its insurance and annuity contracts, and (2) investment income. Life insurers may also raise funds from investors through issuance of corporate stock (stock companies only) or subordinated debt, sometimes referred to as “surplus notes” (stock and mutual companies). This ability to raise needed capital through equity or debt issuance (coupled with the transfer of existing assets within an insurer’s holding company) was identified in a recent report from the Government Accountability Office as among the chief reasons many large life insurance companies were able to recover quickly from the financial crisis of 2008.<sup>67</sup> Both sources of capital funding are subject to regulatory oversight by the insurer’s domestic commissioner.<sup>68</sup> Although an insolvent insurance company’s general creditors have legal claims against the insurer’s general account, state law gives policyholders, including annuity contract

owners and GAs (to the extent of the consumer protection they provide), the highest priority claims against the insurer’s general account after the administrative expenses of the insurer’s receivership.

Insurers are also authorized to establish one or more separate accounts to support specific products issued by the insurer. The assets in the separate account may be used only to meet the insurer’s policy obligations under the products supported by the separate account. The policyholders have no legal or beneficial ownership interest in the separate account, and the insurer is prohibited under applicable insurance law from representing that the assets in the separate account are held in trust for the benefit of the policyholders or contract holders. In effect, a separate account creates a security interest for the benefits backed by the separate account. The insurer remains fully liable for all the annuity benefits it has guaranteed regardless of whether the separate account is sufficiently funded to cover the annuity benefits it was created to protect. If at any point the value of the assets held in the separate account is not at least equal to the insurer’s liability for the annuity obligations backed by the separate account, the insurer is required to establish and hold a reserve in its general account for the deficit.

ERISA regulations do not necessarily require that plan-purchased annuities be backed by separate accounts, but Department of Labor guidance includes, among six “types of factors a fiduciary should consider” in carrying out its ERISA fiduciary duties, the “structure of the annuity contract

and guarantees supporting the annuities, such as the use of separate accounts.”<sup>69</sup> In a transaction utilizing a separate account, the amount deposited in the separate account is available only to support the insurer’s benefit payment obligations to the former plan participants. The separate account effectively grants former plan participants a type of secured creditor status, which is further backed by recourse against the insurer’s general account assets, if the separate account assets are insufficient to satisfy obligations to payees. One large de-risking transaction elected to split the pension plan’s payment obligations equally between two independent life insurers, rather than using a single insurer and a separate account.<sup>70</sup> And at least one large sponsor is reported to have made use of both a split transaction and a separate account.

### **Insurance solvency-regulation mechanisms**

To assure an insurer’s ability to meet obligations under policy commitments, state insurance laws focus primarily on reporting adequate reserves for the insurer’s insurance and annuity obligations, maintaining capital and asset levels that exceed the insurer’s policy obligations, and requiring the insurer’s assets to be invested in a sound portfolio. The process starts with establishing appropriate “reserves”—in effect, the present value at any time, typically each year-end, of all the insurer’s insurance and annuity obligations. Insurers must use NAIC-approved mortality tables and maximum discount rates, which vary based on the annuity contract’s issue year, to establish a reserve value for the insurer’s annuity obligations. Each year an insurer’s aggregate reserves, along with the assets backing those reserves, are cash-flow tested using various modeling techniques (including stochastic testing) to determine whether they are adequate in the aggregate under a range of moderately adverse conditions (including economic environments) or need to be strengthened. An actuarial opinion is required as to the adequacy of the assets backing the liabilities.<sup>71</sup>

The insurer’s assets must *at all times* exceed its insurance obligations by a significant margin, generally measured by risk-based capital (RBC) calculations performed as of each year-end.<sup>72</sup> RBC calculations are intended to measure the minimum acceptable level of capital necessary for the insurer to support its business in view of its size and risk profile before remedial action (by either the insurer or its domestic regulator) must be taken, effectively limiting the amount of risk the insurer can assume. The higher the risk of an insurer’s insurance and annuity obligations, the higher the amount of capital the insurer must maintain. RBC values establish a minimum regulatory capital standard unique to each life insurer and its business. The NAIC’s RBC formulas establish that minimum level by focusing on four major areas: (1) asset risk, (2) underwriting risk, (3) interest rate and market risk, and (4) other risk. No parallel requirement is applicable to ongoing pension plans under the federal system, and funding deficits for ongoing pension plans covered by the PBGC program are permitted.

The RBC results determine whether the insurer exceeds defined thresholds that would trigger corrective action. The thresholds are often described as a ratio of its “Authorized Control Level RBC”—where the insurer’s financial condition has deteriorated sufficiently to authorize the domestic insurance commissioner to take control of the insurer. An earlier warning threshold, the “Company Action Level RBC,” is typically 200% of the insurer’s Authorized Control Level RBC, or 300% of its Authorized Control Level RBC if the insurer is experiencing a negative trend. If the ratio of an insurer’s Total Adjusted Capital to its Authorized Control Level RBC falls to the Company Action Level RBC, the insurer must submit to its domestic insurance commissioner an explanation for that condition and a plan for raising its Total Adjusted Capital above that threshold. If the insurer’s RBC ratio falls to lower thresholds, the domestic insurance commissioner may take more aggressive action to address the insurer’s finances and operations.

This regulatory scrutiny allows an insurance regulator to intervene early if an insurance company is in trouble—before assets are less than the reserves needed to meet the insurer’s benefit obligations.

Since the RBC metrics are a regulatory tool for monitoring a life insurer’s financial condition, not a financial standard for marketing purposes, the RBC ratios are not published. The Authorized Control Level RBC, however, is published annually for each insurer and can be compared to the Total Adjusted Capital for the insurer.<sup>73</sup> The NAIC also provides an annual Summary Report that shows the results for all reporting companies in the aggregate.<sup>74</sup> According to data compiled by the American Council of Life Insurers, the 2014 RBC ratios for the 50 largest individual life insurers ranged from 652% to 3,508%, with an average RBC ratio for these insurers of 1,074%. These results are significantly higher than the highest early warning “Company Action Level RBC” for any of these insurers (e.g., an RBC ratio of 300% if the insurer is experiencing a negative trend).

In addition, state insurance commissioners heavily regulate and closely monitor life insurer investments, because the bulk of a life insurer’s assets are invested to meet the insurer’s long-term policy obligations.<sup>75</sup> Life insurers must generally invest in highly rated, investment grade debt obligations. Some investments in equities are permitted, but in limited amounts. Unlike pension plans, whose portfolios usually include at least 60% equities, life insurers are generally restricted from investing in the aggregate more than 20% of their admitted assets in equities listed on a qualified exchange, or more than 5% in the aggregate in equities of unaffiliated entities not listed on a qualified exchange.<sup>76</sup> Insurers must also diversify their investments, with generally no more than 3% of a life insurer’s admitted assets invested in any single entity.<sup>77</sup> Because of the long-term nature of life insurance and annuity obligations, life insurers generally invest heavily in longer-term assets, like high-grade corporate bonds with long maturities.<sup>78</sup>

**During the same 2008–2015 period that saw the failures of 931 pension plans affecting more than 560,000 participants, no active annuity insurer with unsatisfied annuity obligations was liquidated.**

An insurer’s domestic insurance commissioner confirms compliance with the applicable investment requirements every year.

Each life insurer must submit quarterly and annual financial statements to its domestic insurance commissioner, which are accessible to the insurance regulators in every other state in which the insurer is licensed. The domestic commissioner’s staff reviews those financial statements using a variety of financial tools and metrics to make sure the insurer is complying with financial requirements and to identify potential financial and solvency issues. Those financial tools and metrics have evolved over time as a result of experience gained from prior life insurer impairments and insolvencies, especially during periods of significant financial stress in the life insurance marketplace.

State insurance regulators must also conduct on-site, risk-focused financial examinations every three to five years, but may do so more frequently when circumstances warrant. The “triennial examinations” involve a deeper investigation of the insurer’s financial condition and the processes and controls the insurer has implemented to avoid financial losses.

## **The insurer's assets must at all times exceed its insurance obligations by a significant margin, generally measured by risk-based capital (RBC) calculations performed as of each year-end.**

Life insurers also face public scrutiny of their financial condition. Significant life insurers maintain financial ratings by at least one public rating agency. To conduct business, particularly issuing annuities in connection with ERISA pension plans, life insurers must generally maintain ratings in the highest financial rating categories. The most widely known rating agencies for life insurance companies are A.M. Best, Standard and Poor's, and Moody's Investors Service.<sup>79</sup>

### **Insurance company failure experience**

The recent financial crisis and its aftermath had a limited effect on the insurance industry and policyholders, and those few life insurers that did experience any capital or liquidity pressure generally rebounded quickly.<sup>80</sup> In fact, during the same 2008–2015 period that saw the failures of 931 pension plans affecting more than 560,000 participants, no active annuity insurer with unsatisfied annuity obligations was liquidated.<sup>81</sup>

### **Current insurance company financial health**

Like all financial services industry sectors, the life insurance industry experienced stress during the financial crisis, but it weathered the crisis comparatively well. Although much has been said and written about AIG and its “too big to fail” presence that resulted in a federal rescue of that company, in reality the problems at AIG did not arise within the operating insurance companies or prevent them from meeting their policyholder

obligations, either before or following the Great Recession.<sup>82</sup>

Published data demonstrate that the overall financial health of the life insurance industry recovered quickly and remains strong. For example, the NAIC's Summary Report of RBC results for the period of 2007–2014 shows, not surprisingly, that the industry low point, as measured by the median RBC ratio for all reporting life insurers, occurred as of year-end 2008.<sup>83</sup> Even then, however, the median RBC ratio of Total Adjusted Capital to Authorized Control Level RBC for all reporting life insurers was 910%. In other words, instead of being less than 100% funded to meet benefit obligations, a life insurer at the median RBC had Total Adjusted Capital of more than 9 times the amount that would permit (but not require) an insurance regulator to take control of a life insurer. Since 2008, both the median and the aggregate RBC ratios for the life industry have improved and remain strong.<sup>84</sup> In fact, the median and aggregate RBC ratios for 2013 were the highest during the 10-year period reported. A 2013 report published by the NAIC and the Center for Insurance Policy and Research found that medium to large annuity insurers rebounded from the financial crisis more quickly than smaller insurers through a combination of raising new capital and cutting dividends.<sup>85</sup> That reality reinforces the funding importance of access to the capital markets—a strategy not directly available to private pension plans.<sup>86</sup>

**SUMMARY OF INSOLVENCY PREVENTION IN THE TWO SYSTEMS**

Insurance regulators enforce stricter financial controls on insurance companies than the ERISA system applies to defined benefit pension trusts. Most notably, life insurers must at all times maintain assets significantly in excess of their insurance obligations, and the minimum capital requirement increases with the insurer’s risk level. ERISA defined benefit pension plans, on the other hand, can and oftentimes do run for years at a time with total assets lower than their pension obligations, and ERISA does not require that pension plans hold additional assets to insure against equity, credit, longevity, or interest rate risks. But more importantly, the federal system places no financial controls at all on the ultimate source of each pension plan’s funding—the business that employs the participants and bears the ultimate responsibility to fund promised benefits. The plan is not required to hold assets equal to or in excess of plan obligations, and the plan sponsor is not required to hold capital. There is no federal pension plan equivalent to the RBC calculations or cash flow testing that would measure the financial capability of the pension plan or the plan sponsor to satisfy the promised benefits. Nor is there a federal regulator charged with ongoing monitoring of the financial condition of plan sponsors and, if necessary, overseeing the rehabilitation of a plan sponsor. The PBGC has some leverage to intervene and demand corrective action when a weak pension plan or plan sponsor creates risk for the PBGC, but that power is not the equivalent of the ongoing regulatory financial monitoring that is at the core of the insurance regulatory system.

active block of annuity business failed during this period. By contrast, that same period saw the failure of 931 single-employer pension plans affecting more than 560,000 participants.

The relative strength of the insurance regulatory controls is reflected in the comparative failure rates during the financial crisis and recovery. While only five small life insurers have failed since 2008, no operating life insurer with an



# THREE

## How the Systems Protect Benefits After Payer Insolvency

If the first line of consumer defense fails, and a pension plan or insurance company becomes insolvent, the pension system (through the PBGC) and the insurance system (through the GAs that are members of NOLHGA) have resolution mechanisms and backup “safety net” programs to ensure that benefits expected by consumers will be substantially protected. The two systems make use of different guaranty methodologies and claims priorities, and those differences make a direct comparison difficult. On balance, however, both systems provide a very high level of protection.

### THE PBGC SAFETY NET FOR FAILED PENSION PLANS

#### PBGC pension guaranty and federal priority formulas

For single-employer, defined benefit pension plans, PBGC guaranties usually are triggered when an underfunded plan goes through a distress termination (initiated by the employer) or an involuntary termination (initiated by the PBGC). For each participant, the PBGC generally guarantees the vested pension benefit under the plan, payable as an annuity over the participant’s lifetime (and a survivor’s lifetime, if applicable), up to a maximum amount that varies with the participant’s age at the effective date (the later of the PBGC’s triggering date or the participant’s retirement date). If a participant’s plan benefit is payable in the form of a joint-and-survivor annuity, the benefit guaranty is reduced actuarially to account for the survivor interest.

For PBGC-covered plans terminating in 2015, the following are representative monthly maximums (rounded to the nearest dollar):<sup>87</sup>

- at 55—single-life annuity of \$2,255/month; joint-and-survivor (50%) annuity of \$2,030/month;
- at 65—single-life annuity of \$5,011/month; joint-and-survivor (50%) annuity of \$4,510/month;
- at 75—single-life annuity of \$15,235/month; joint-and-survivor (50%) annuity of \$13,711/month.

In addition to guaranteed benefits, the PBGC typically pays a small portion of non-guaranteed benefits that are not funded by the assets of the terminating plan based on what the PBGC is able to recover from the terminating plan’s sponsor (and its controlled group affiliates). The recovery—expressed as a percentage of the plan’s unfunded, non-guaranteed benefits—typically results in a “recovery ratio” (as defined by ERISA) in single digits.<sup>88</sup>

The PBGC guaranties do not apply fully to new plans, or to benefit increases by plan amendments that are adopted within a 5-year period ending with the plan’s termination. In general, the guaranties phase in ratably over the 5-year period.<sup>89</sup>

When a defined benefit pension plan is terminated without sufficient assets to meet its benefit obligations, the PBGC takes over the plan’s payment obligations and all the plan’s trust assets. The PBGC must allocate the trust assets to help fund different categories of plan benefits, in order of six priority categories (PCs):<sup>90</sup>

- PC 1. Benefits derived from participants’ non-mandatory contributions;

- PC 2. Benefits derived from participants' mandatory contributions;
- PC 3. Benefits for participants who started receiving distributions (or could have retired and started receiving distributions) at least 3 years before plan termination, based on plan provisions in effect 5 years before plan termination;
- PC 4. Other benefits guaranteed by the PBGC;
- PC 5. Other non-forfeitable plan benefits under the plan; and
- PC 6. Other (forfeitable) plan benefits.

As a result of those allocation categories, an underfunded plan's assets are generally used first to pay all benefit amounts guaranteed by the PBGC—except for any higher benefits in category 3 (which may exceed PBGC-guaranteed amounts)—and only the remaining plan assets, if any, are available to pay non-guaranteed benefits.

In short, the distressed plan's assets are often used to pay benefits that the PBGC's guaranties would otherwise have to cover. While one category of participants (the longer-term retirees or retirement-eligible participants in PC 3) may receive benefits in excess of PBGC guaranty limits (if trust assets are sufficient), all other participants in failed plans are generally limited to the PBGC guaranties, plus minor "recovery ratio" amounts. In other words, a participant in a failed pension plan generally receives benefit protection as a "greater of A or B" approach—either (A) the PBGC's guaranteed benefit level or (B) benefits supported by the participant's share of the failed plan's assets (determined by priority categories), but not both.

**Actual pension benefit loss experience**

In 2008, the PBGC published a report that summarized how the PBGC limits have affected participants in failed single-employer plans. According to the report, a 1999 study had found that fewer than 6% of participants in PBGC-trusted plans lost some benefits and that the average loss for

those participants was 16%. By the 2008 report, however, the impact was greater (in part because of changes made by the Pension Protection Act of 2006)—the PBGC limits and other adjustments affected 16% of the participants in PBGC-trusted plans, and the average benefit reduction for those affected was 28%.<sup>91</sup>

**THE GUARANTY ASSOCIATION  
SAFETY NET FOR FAILED INSURANCE  
COMPANIES**

**Insurance guaranty and priority formulas**

In the relatively rare cases when an annuity issuer fails financially, GAs step in to protect the annuity certificate holders. Every state has a GA that provides a guaranteed minimum level of protection to the state's residents. And unlike the pension system's "greater of A or B" approach, the insurance system gives each policyholder the benefit of an "A plus B" approach, allowing a policyholder with benefits exceeding GA coverage levels to receive both (A) the GA coverage level of benefits; and (B) benefits supported by the policyholder's share as a priority claimant of the insurer's remaining assets, which are usually substantial.

For annuities used in pension de-risking transactions, all state GAs provide, as a guaranteed minimum level, protection for at least \$250,000 in present value of future annuity payments for each covered life. As of year-end 2015, 14 states extend that coverage level to \$300,000 or more per life for annuity payout benefits, and four of those states extend that coverage level to \$500,000 per life.

The present value of future annuity payments is determined by appropriate mortality tables and discount rates. If the present value of annuity benefits does not exceed the GA guaranty level, the GA will pay all future benefits, even if the aggregate amount of all payments ultimately exceeds the stated GA present value guaranty level.<sup>92</sup> If the present value of an annuitant's

### THREE: How the Systems Protect Benefits After Payer Insolvency

---

benefits exceeds the GA's guaranteed level, the GA will pay a percentage of the annuity benefits, equal to the ratio of the guaranty level to the benefit's total present value, and the GA will continue those payments for the annuitant's lifetime, even if the aggregate amount of all payments eventually exceeds the GA's present value guaranty level.

Consumer protection does not end with the GA's guaranty. Under insurer-liquidation statutes, all annuitants, along with other policy owners and the GAs, share a priority claim to the insolvent insurer's remaining assets. As a result, if some annuity benefits exceed the GA guaranty level, excess claims (for benefits higher than those covered by GAs) are entitled to share in the insolvent insurer's assets in the same proportion as all other policy-level claimants. That statutory structure results in significant additional protection to annuitants with benefits exceeding the amounts guaranteed by the GAs. In other words, GA coverage should be viewed as providing a minimum protected benefit—in effect a “floor”—with no limit on the ability of an annuitant to recover all benefits due if the insolvent insurer's remaining assets are adequate to cover the claims of all policyholders.

For example, assume the following: (1) a failed life insurer had a funded ratio of 90%—assets equal to 90% of its insurance liabilities (which is not uncommon when life insurers fail);<sup>93</sup> (2) two spouses were covered by a joint-and-survivor annuity of \$3,000 per month (with no reduction after the death of the primary annuitant); (3) the couple resides in a state that guarantees \$250,000 of annuity present value “with respect to one life”; and (4) the total present value of the joint-and-survivor annuity is calculated to be \$500,000—consisting of \$350,000 for the primary annuitant's lifetime and \$150,000 for the survivor's remaining lifetime. Under those assumptions, which include a benefit level far in excess of typical pension benefits, the insurance system will protect 98% of the couple's annuity benefits, as explained below:

- The GA would guarantee \$400,000 of that annuity's \$500,000 value—\$250,000 (out of \$350,000) for the primary annuitant plus \$150,000 for the survivor.<sup>94</sup> With an aggregate GA coverage percentage of 80% (\$400,000 divided by \$500,000), the GA would pay 80% of each \$3,000 monthly benefit, or \$2,400 per month, as long as either annuitant is alive.
- That would leave \$600 of each monthly payment (with a \$100,000 present value) not covered by the GA guaranty. But that \$600 excess amount would share a priority claim to the insurer's remaining assets. Since the insurer's assets in this example equal 90% of its policy liabilities, the couple would receive, from the insurer's assets, 90% of the \$600 excess amount, or \$540 per month, with a present value equal to 90% of \$100,000, or \$90,000.
- As a result, \$490,000 of the couple's total annuity value would be protected by the combination of the GA guaranty and the priority claim to the insurer's assets.<sup>95</sup> That would produce total protected payments of \$2,940 (\$2,400 plus \$540) per month, or 98% of the original \$3,000 monthly benefit.<sup>96</sup>

Unlike the PBGC guaranty for pension plan benefits, the GA guaranties do not reduce coverage for annuity benefits purchased shortly before insolvency. Nor are the holders of uncovered benefits subject to different priority rights to the insurer's remaining assets—all annuity benefits have the same priority claim to the insurer's assets, without regard to the annuitant's age or retirement status.

As described above, the GAs fund their guaranteed benefits from two primary sources. First, the GAs step into the shoes of the policyholders whose protection they provide to the extent of their guaranteed benefits, so they share with uncovered policyholders a priority claim on the insurer's remaining assets. In the example above, that would yield assets of \$360,000 (90% of \$400,000). Second, a GA covering an annuity payee in this example would collect the necessary additional funds by assessing every life insurer

**Although the two systems use a variety of mechanisms to satisfy benefit claims, the two most important elements are (1) the level of an individual's benefits that are directly guaranteed, and (2) the extent to which an individual will benefit from the assets of the insolvent payer (whether pension plan or insurance company).**

licensed in the GA's state for its share of the guaranteed benefit costs.

Although not required by law, in many large de-risking transactions, the pension plan has arranged for the insurer to create a fully funded "separate account" as security for all the insurer's benefit obligations to the former plan participants transferred to the insurer under the group annuity contract. The separate account is owned by the insurer, but by state statute, the insurer cannot use the separate account assets for any purpose other than to pay the liabilities for which the separate account was established. For benefits supported by a separate account, the technique effectively grants annuitants (for example, former pension plan participants) a type of secured-creditor status, making the insurer's solvency status less important than the separate account's funding level. As long as the separate account is fully funded to support the related annuity contracts, the insurer's insolvency (regardless of funded ratio) would cause no reduction in the related annuity benefits. If the separate account assets were ever to fall below the applicable annuity benefit liabilities, the annuitants would be protected by GAs, and their claims in excess of separate account assets and GA coverage levels would be a claim against the insurer's general account and would share, to the extent of the separate account shortfall, the

same priority claim as other policy-level claimants to the insurer's general assets.

As noted above, in at least two recent de-risking transactions, the pension plans split their annuity purchases equally between two major unrelated life insurers. That approach spreads the solvency risk between two insurers and results in twice the level of available GA guaranties, because GA guaranties are determined on a per-person/per-insurer basis at the time of an insurer's liquidation. For example, assume that a pension plan participant lived in a state with a \$250,000 GA coverage level, but had a total pension benefit with a present value of \$500,000 at the time of a failure. If the plan had transferred the entire benefit obligation to a single insurance company and the insurance company failed, only half of the participant's benefit would fall within the GA's coverage level. But if the plan split that benefit obligation equally between two unrelated insurers, the participant's entire benefit would fall within GA coverage levels, because each \$250,000 portion would be entitled to its own \$250,000 GA guaranty. In the event one of the insurers were to fail, the half of the benefits being provided by the second solvent insurer would be unaffected (i.e., the annuitants would continue to receive 100% of that half of their benefits being paid by the solvent insurer). The half of the annuity benefits promised by the insurer

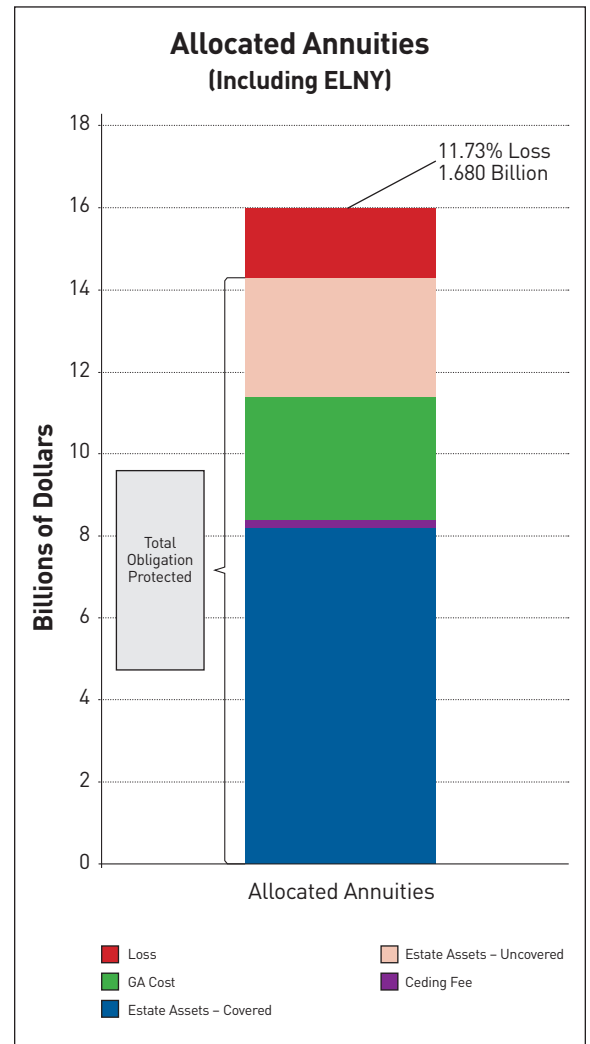
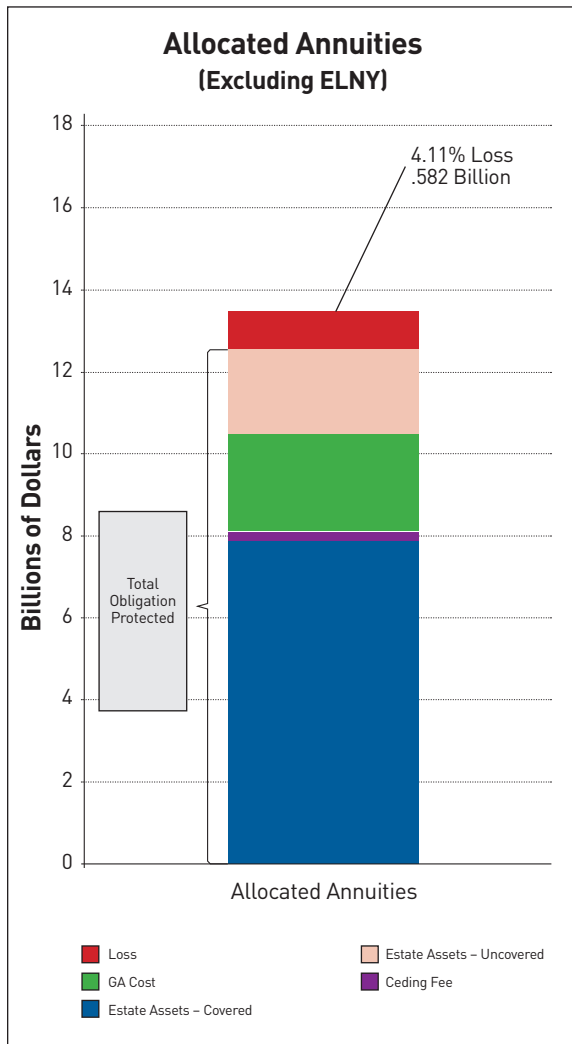
### THREE: How the Systems Protect Benefits After Payer Insolvency

becoming insolvent would be protected by the GA up to the full present value per life coverage level. If the benefits promised by the failed insurer exceed the maximum present value GA coverage level, the excess benefits would be supported by the insolvent insurer's remaining assets as described in the example above. In the unlikely event that the second insurer also were to fail, the benefits promised by that insurer would also be covered up to the full per-life GA present value coverage level without any reduction from the GA benefits provided as a result of the first insurer's

failure. So, by splitting pension benefits between two insurers, the solvency risk is split between two insurers, and the plan participants receive twice the level of GA coverage.

#### Actual insurance benefit loss experience

NOLHGA's data show that policyholders and annuitants have fared well historically in insurance company insolvencies, especially in insolvencies of large annuity issuers that might be considered by pension plan fiduciaries for de-risking transactions. The bar graphs below



demonstrate that—through a combination of the GA guaranties, claims against insolvent insurers’ remaining assets, and other carriers’ assumption of failed insurers’ policies—insurer failures from 1991–2014 caused annuities to experience an aggregate loss of 11.73%, including the effect of the anomalous ELNY case<sup>97</sup> and its extraordinarily large structured settlement annuities and unusually high asset shortfall.<sup>98</sup> By removing the distorting effect of the outlier 1991 ELNY failure (which occurred before the modern regulatory enhancements and their focus on risk-based capital), annuitants’ experience improves to an aggregate loss of only 4.11%. In all cases, the losses were borne by those individuals who had the largest benefit levels in excess of GA guaranty levels, and their loss experience varied by the size of their excess benefits and the value of the insurer’s remaining assets.

#### **SUMMARY OF POST-INSOLVENCY PROTECTIONS IN THE TWO SYSTEMS**

If a pension plan or an insurance company actually reaches the point of financial failure, both systems provide very strong benefit protection for the affected individuals. As reflected in the Willis Towers Watson Study (summarized in the next section), the two systems have some significant differences in the design and application of their safety net formulas, priorities, and other details, but both systems cover the vast majority of all benefit claims. For the small minority of benefit claims not fully covered, at the margins, each system may provide slightly better coverage than the other with respect to individuals in particular situations.

Although the two systems use a variety of mechanisms to satisfy benefit claims, the two most important elements are (1) the level of an individual’s benefits that are directly guaranteed, and (2) the extent to which an individual will benefit from the assets of the insolvent payer (whether pension plan or insurance company). In general, the PBGC guarantees pension benefits at a higher level than the annuity level that most state

GAs guarantee. The PBGC maximum is slightly more than \$5,000 per month for a single-life annuity starting at age 65 (for 2015 plan terminations), while most guaranty associations use a \$250,000 present-value maximum “with respect to one life.”

On the other hand, the insurance receivership process, operating as it does in tandem with the guaranty system, allows most individuals to benefit from a substantially higher share of an insolvent annuity issuer’s assets than would be available from the assets of a failed pension plan. With the exception of one category of participants (those actually receiving, or eligible to receive, retirement benefits for at least three years before plan termination), the PBGC uses plan assets to satisfy PBGC-guaranteed benefits and generally pays participants little from the plan or sponsoring employer to cover benefits above the guaranteed level. For insurer insolvencies, policyholders with claims exceeding the levels guaranteed by GAs have priority claims to the insolvent company’s assets, ranking *pari passu* with all other policy-level claims (including those of GAs for covered claims.) That priority creditor status for such “excess” claims in fact provides substantial protection in addition to the baseline protection levels that are guaranteed by GAs.

For example, if an insolvent insurer had a funded ratio of 75%, a policyholder would receive payment for 75% of the benefit claim amounts exceeding the amount fully guaranteed by the GA. By contrast, if a pension plan had the same funded ratio, plan participants (other than those in the actual/eligible retirement priority category) would receive a much smaller percentage (typically in single digits) of claims in excess of the PBGC guaranty. Those plan participants in the actual/eligible retirement priority category might end up with some higher protection from the plan’s assets for benefits in excess of the PBGC guaranty, depending on how much of the plan’s liability would be attributable to those benefits.

### THREE: How the Systems Protect Benefits After Payer Insolvency

The ultimate level of protection any individual would receive under either system for the same level of promised benefits would be driven by many different factors—some unique to the individual (e.g., age, promised benefit level, and (for the PBGC) whether the individual was or could have retired), and some based on the financial condition of the failed payer (e.g., the funded ratio and (for the PBGC) the aggregate levels of benefits falling within each of the “PC” categories). To help illustrate and compare how the two safety net mechanisms would operate in some specific individual situations, several examples drawn from the sample Hourly, Salaried, and Retiree Plans that Willis Towers Watson analyzed in its study are included in the attached Appendix.

Table 2 (below) summarizes the most significant differences between the two systems’ guaranty and priority mechanisms.

#### **WILLIS TOWERS WATSON STUDY**

At NOLHGA’s request, Willis Towers Watson performed a quantitative analysis that compared the post-insolvency benefit protections under the PBGC safety net with those under the GA safety net. The Willis Towers Watson Study did not attempt to compare the systems’ relative strengths in assuring the financial health of private pension plans and private annuity issuers (discussed in Part TWO above). Instead, the study focused on how the systems restore promised benefits in the event a pension plan or insurer actually fails (discussed in this Part THREE).

The Willis Towers Watson Study used sample populations, drawn in part from actual insolvencies and in part from typical demographic and benefit patterns, to compare the PBGC protection levels for a pension plan insolvency to the GA protection levels in an annuity issuer insolvency—

**Table 2. Differences Between the Two Systems’ Guaranty and Priority Mechanisms**

	<b>Pension System</b>	<b>Annuity (Insurance) System</b>
<b>Guaranty maximum</b>	slightly more than \$5,000 per month as a single-life annuity at age 65 (for 2016 plan terminations)	present value “with respect to one life” of at least \$250,000
<b>Application to joint and survivor annuities</b>	single reduced maximum applies	separate maximum applies to each covered life
<b>Priority of claim, as among individuals, to insolvent payer’s assets</b>	longer-term retirees and retirement eligibles* have priority over other participants	all insureds have the same priority
<b>Priority of claim, as compared to guarantor, to benefit of insolvent payer’s assets</b>	plan assets used first to pay PBGC-guaranteed benefits (except for longer-term retirees and retirement eligibles*)	all policy-level claims have equal priority (including those of GAs)
<b>Coverage for recent benefit increases</b>	limited coverage for benefits added within 5 years of termination	full coverage for all earned benefits, including recent benefit enhancements

\* Participants who have been receiving, or have been eligible to receive, retirement benefits for at least three years before plan termination, based on plan provisions in effect five years before plan termination.

### THREE: How the Systems Protect Benefits After Payer Insolvency

---

assuming identical populations of covered individuals (as the plan participants or the annuity payees) and equal funded ratios for the private payers (the pension plan versus the insurer's general account).<sup>99</sup> Willis Towers Watson noted that this approach was necessary because the federal-state comparison is "highly dependent on certain key features of the population for which the comparison is made"—including participant ages, benefit amounts, history of plan changes, early retirement provisions, and prevalence of different payment forms—and using actual data was an objective approach for defining these critical features for comparison.<sup>100</sup> The study also applied the same mortality and discount rates used in an actual insurer liquidation case and made additional assumptions that included the following:

- the pension plans terminated in 2014 and were subject to PBGC guaranty limits and equivalence assumptions for 2014 terminations;
- the annuity issuers failed and triggered GA coverage in 2014;
- the GA coverage level was \$250,000 per covered life, including spouses for joint-and-survivor annuities;<sup>101</sup>
- one-half of plan participants not yet retired would receive 50% joint-and-survivor annuities;
- for participants not yet retired, benefit payments would start at age 65; and
- annuity purchases did not involve the added security (unlike several recently reported de-risking transactions) of either insurance company separate accounts or splitting annuity purchases between multiple insurers.

Willis Towers Watson compared the safety nets using three different pension plan populations with representative characteristics: (1) an "Hourly Plan" that covered both unionized and non-unionized hourly paid employees (including active employees, vested former employees not yet receiving benefit payments, and retirees already receiving payments) and had a history of benefit improvements; (2) a "Salaried Plan" that covered a salaried workforce (including active, terminated vested, and retired participants)

and benefit amounts broadly comparable to recent annuity-purchase transactions; and (3) a "Retiree Plan" that included only salaried participants who had retired and were receiving benefit payments. For each plan population, the study measured each system's protection level on a "Headcount Basis"—comparing the numbers of participants with 100% protection in each system, as well as the numbers and average protection levels of the remaining participants not receiving 100% protection—and on an "Obligation Basis"—comparing the protected percentages of participants' aggregate benefits (at present value).

The following explanations and bar graphs summarize the comparative protections provided for each plan population, at various funded ratios, under the pension and insurance safety nets. In each Headcount Basis graph, each pair of columns compares, at a particular plan and insurer funded ratio, the protection that covered individuals would receive from the pension and insurance resolution and safety net systems. In each column, the lower box (completely filled with the darker color) represents the number of individuals with fully protected benefits. The upper box represents the number of participants whose benefits are partially covered, and the lighter color-filled portion of the upper box reflects the average protection percentage for those partially covered individuals. In each Obligation Basis graph, each pair of columns compares, at a particular plan/insurer funded ratio, the percentage of aggregate benefits that would be protected under both safety nets for the entire population of covered individuals. All of the bar graphs are based on the Willis Towers Watson quantitative analysis that compares pension plan failures to insurance company failures at the same funded ratios. Historical experience shows that such a comparison does not provide a complete picture, because the funded ratios tend to be materially higher in the rare cases of insurance company failures than the funded ratios when pension plans fail. A more detailed discussion of the impact of higher funded ratios for failed insurance companies follows the comparisons below.



**Hourly Plan**

- *PBGC system:* Without allocating any plan funding—as if the failed plan had a funded ratio (of assets to liabilities) of zero—the PBGC guaranty itself would fully protect all of the benefits for 92% of participants; and for the remaining 8% of participants, the PBGC guaranty would cover 96.5% of their benefits. On an aggregate obligation basis, the PBGC guaranty itself would cover 99.5% of the plan’s overall obligations. After adding in participant rights to the plan’s remaining assets, participants would not receive additional protection unless the plan’s funded ratio was at least 99.5%.
- *State guaranty system:* Before allocating any insolvent insurer’s assets—as if the insurer’s funded ratio were zero—the GA guaranty would fully protect all benefits for 98% of annuitants; and for the remaining 2% of annuitants, 77% of their benefits. On an aggregate basis, the GA guaranty itself would cover 96.9% of the insurer’s overall annuity obligations.

er’s overall annuity obligations. After taking into account the participants’ rights to the insurer’s remaining assets (and assuming a funded ratio of 85%), the GA system would provide full protection for the same 98% of annuitants; the remaining 2% of annuitants would have 96.5% of their benefits covered; and, on an aggregate basis, the GA system would cover 99.5% of all annuity obligations.<sup>102</sup>

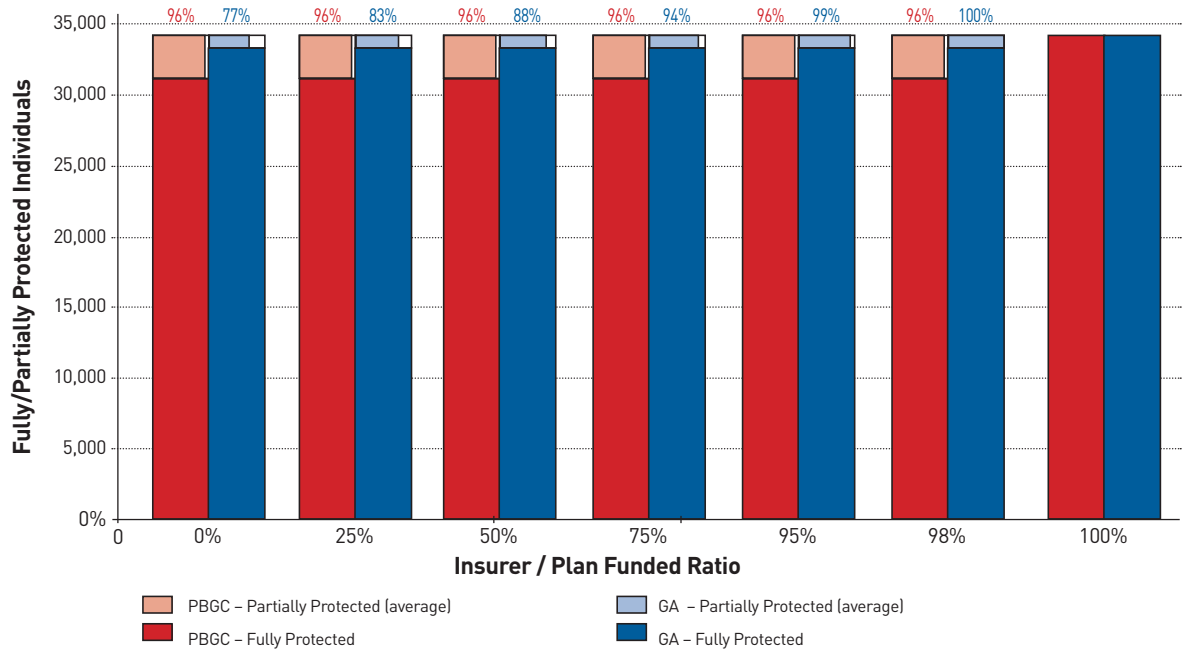
- *Comparison:* The GA system would leave fewer individuals with benefit reductions, and its overall coverage percentage would be somewhat higher than the PBGC’s overall percentage if the insurer’s funded ratio was at least 85%. Comparisons on a Headcount Basis and an Obligation Basis are reflected in the “Hourly Plan” bar graphs. The percentage numbers at the top of each bar in the “Headcount Basis” graph identify the average protection received by those individuals who would not be fully protected.

**Historical data, however, demonstrate first that failures of life insurers writing annuities are rare, while pension plan failures are more common; and second that, in the relatively rare cases when insurance companies have failed, their funded ratios have been materially higher on average than the funded ratios of failed pension plans.**

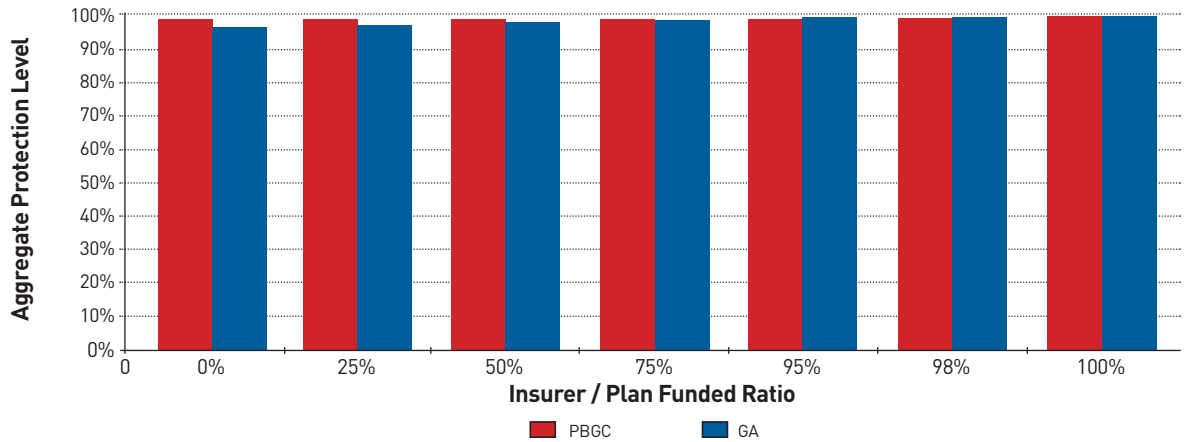
### THREE: How the Systems Protect Benefits After Payer Insolvency



**Hourly Plan — Headcount Basis**  
**Protection by Fully and Partially Protected Participant Groups**



**Hourly Plan — Obligation Basis**  
**Aggregate Protection Level**



**Salaried Plan**

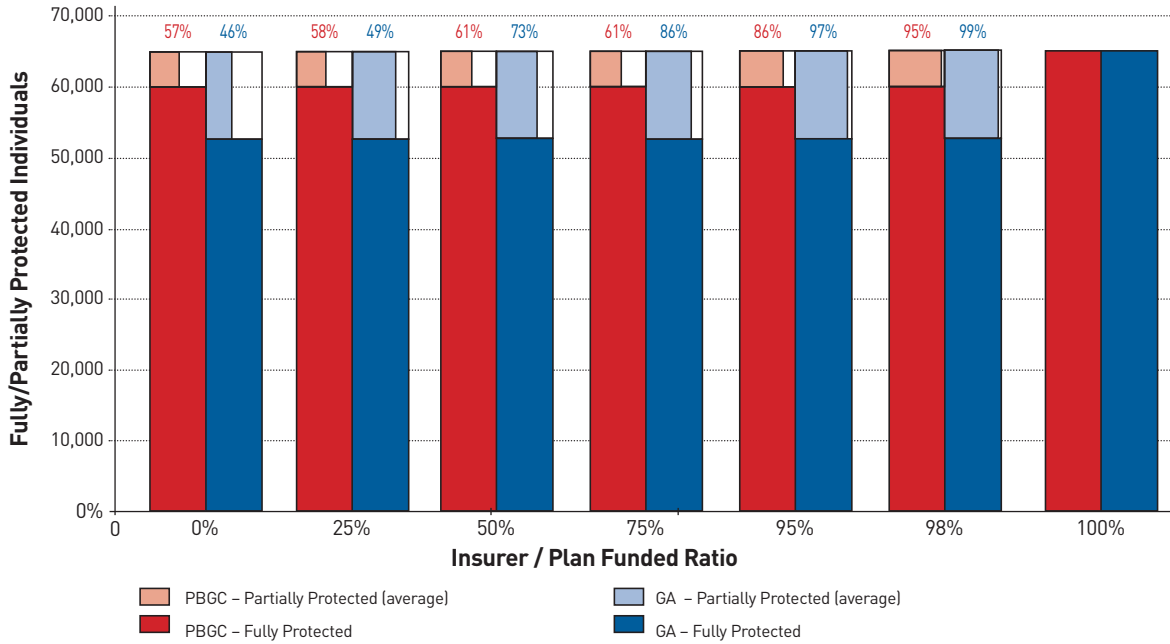
- *PBGC system:* Without allocating any plan funding (as if the plan's funded ratio were zero), the PBGC guaranty itself would fully protect all benefits for 92% of participants; for the remaining 8% of participants, 57% of their benefits; and in the aggregate, 83.7% of all participant benefits. After adding participant rights to plan assets (assuming a funded ratio of 60%), the PBGC system would fully protect the same 92% of participants; for the remaining 8% of participants, 61% of their benefits; and in the aggregate, 86% of all plan obligations.
- *State guaranty system:* Before allocating any of the insolvent insurer's assets (as if the insurer's funded ratio were zero), the GA guaranty would fully protect all benefits for 81% of the annuitants; for the remaining 19% of annuitants, 46% of their benefits; and in the aggregate, 65.3% of overall annuity obligations. After taking into account the participants' rights to the insurer's assets (assuming a 60% funded ratio), the GA system would fully protect benefits for the same 81% of annuitants; for the other 19% of participants, 80% of their benefits; and in the aggregate, 86% of total annuity obligations.
- *Comparison:* If funded ratios exceed 60%, the GA system would protect a higher portion of the overall plan obligations, but the PBGC system would give full protection to a higher percentage of participants. Comparisons on a Headcount Basis and an Obligation Basis are reflected in the "Salaried Plan" bar graphs. The percentage numbers at the top of each bar in the "Headcount Basis" graph identify the average protection received by those individuals who would not be fully protected.

**According to the PBGC's most recent Data Book, the average funded ratio for failed pension plans for the 1990–2013 period was about 52%.**

### THREE: How the Systems Protect Benefits After Payer Insolvency

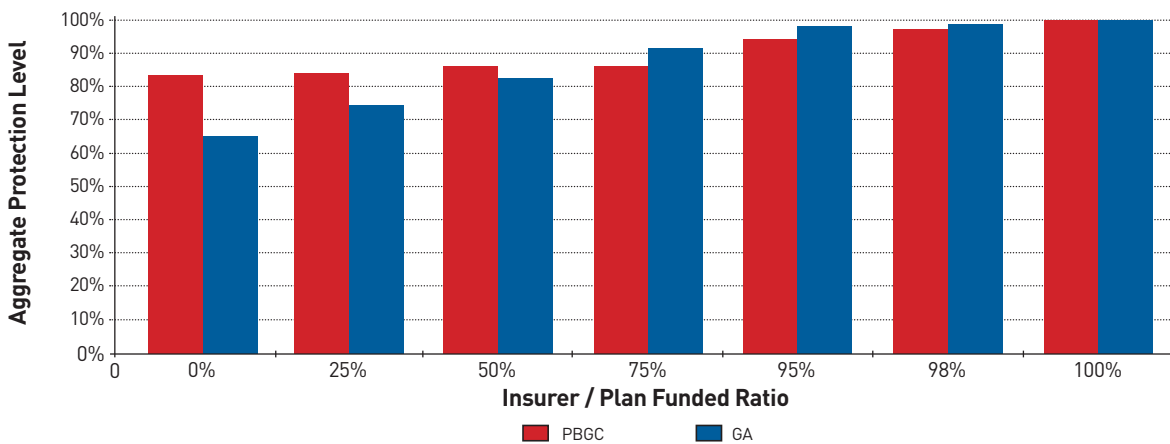
#### Salaried Plan — Headcount Basis

Protection by Fully and Partially Protected Participant Groups



#### Salaried Plan — Obligation Basis

Aggregate Protection Level



**Retiree Plan**

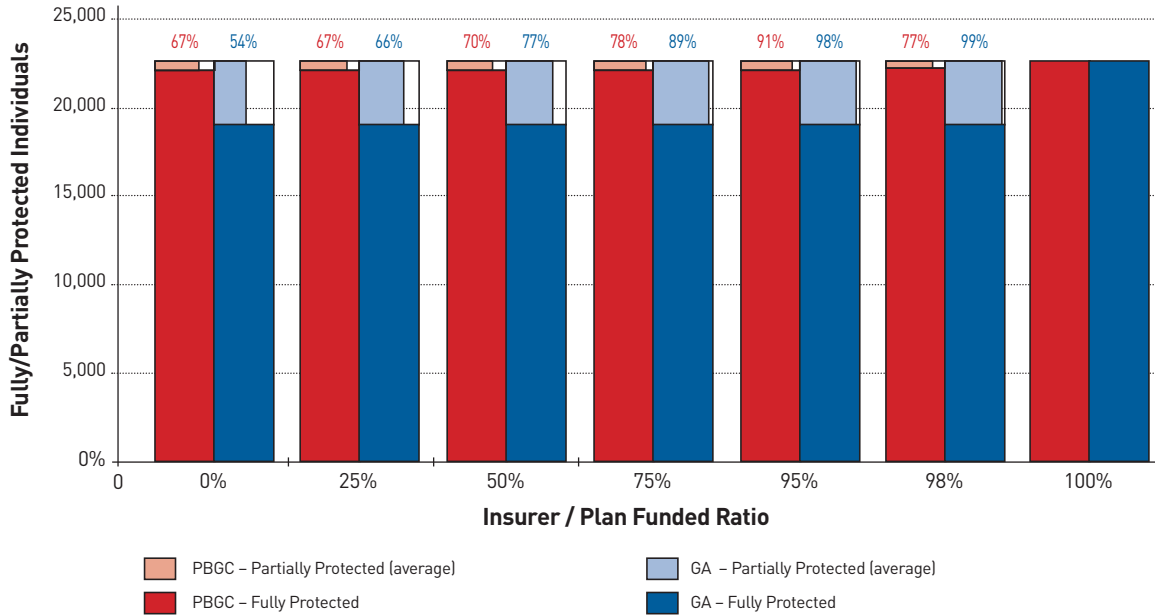
- *PBGC system:* Without allocating any plan funding (as if the plan’s funded ratio were zero), the PBGC guaranty would protect all benefits for 98% of participants; for the remaining 2% of participants, 67% of their benefits; and in the aggregate, 95.1% of the plan’s overall obligations. After adding participant rights to plan assets (assuming a funded ratio of 95%), the PBGC system would protect all benefits for the same 98% of participants; for the remaining 2% of participants, 91% of their benefits; and in the aggregate, 98.7% of overall obligations.
- *State guaranty system:* Before allocating any of the insolvent insurer’s assets (as if the insurer’s funded ratio were zero), the GA system would fully protect all benefits for 84% of the annuitants; for the other 16% of annuitants, 54% of their benefits; and in the aggregate, 73.3% of overall annuity obligations. After taking into account the participants’ rights to the insurer’s assets (assuming a 95% funded ratio), the GA system would fully protect all benefits for the same 84% of annuitants; for the other 16% of annuitants, 98% of their benefits; and in the aggregate, 98.7% of the total annuity obligations.
- *Comparison:* Unless funded ratios were at least 95%, the PBGC system would protect a higher percentage of overall retiree obligations, and at all funding levels under 100%, the PBGC would provide full protection for a higher percentage of retired participants. Comparisons on a Headcount Basis and an Obligation Basis are reflected in the “Retiree Plan” bar graphs. The percentage numbers at the top of each bar in the “Headcount Basis” graph identify the average protection received by those individuals who would not be fully protected.

**The insurance receivership process, operating as it does in tandem with the guaranty system, allows most individuals to benefit from a substantially higher share of an insolvent annuity issuer’s assets than would be available from the assets of a failed pension plan.**

### THREE: How the Systems Protect Benefits After Payer Insolvency

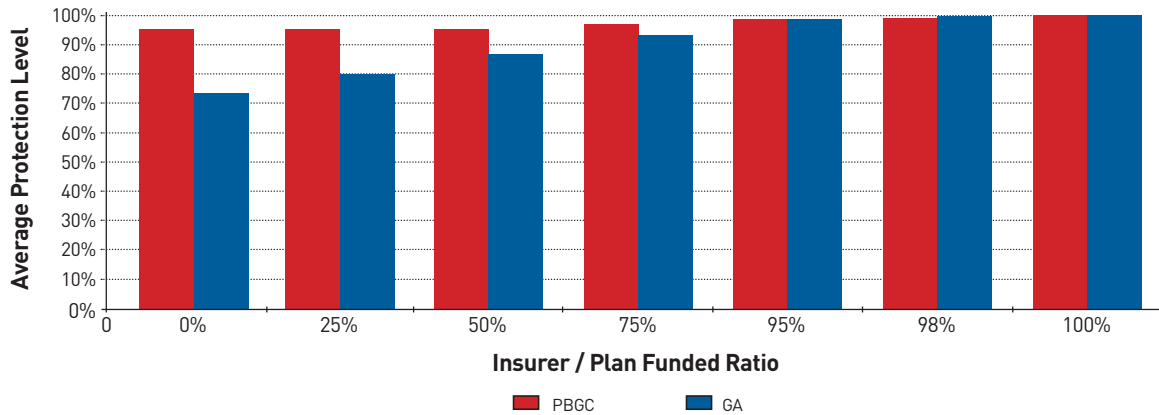
#### Retiree Plan — Headcount Basis

Protection by Fully and Partially Protected Participant Groups



#### Retiree Plan — Obligation Basis

Aggregate Protection Level



### THREE: How the Systems Protect Benefits After Payer Insolvency

---

Overall, the Willis Towers Watson Study reached these general conclusions:

- Both systems provide high levels of protection—over 90% of promised benefits—where the pension plan’s and insurer’s funded ratios are at least 75%.
- The majority of participants are protected at 100% by both systems.
- In both systems, the amount of benefits lost is small in all but the lowest-funded scenarios.
- For lower funded ratios, the PBGC generally provides a higher level of protection to participants where pension plans have benefits that are below PBGC guaranty levels and have not had recent increases.
- The GA system generally provides a higher level of protection where pension plan benefits exceed the PBGC guaranty levels, when recent plan amendments have increased benefit levels, and when funded ratios are relatively high.
- The cross-over point—where the GA system begins to provide a higher level of protection than the PBGC system—depends primarily on the proportion of benefits exceeding PBGC guaranty levels and the presence of recent plan amendments to increase benefit levels.

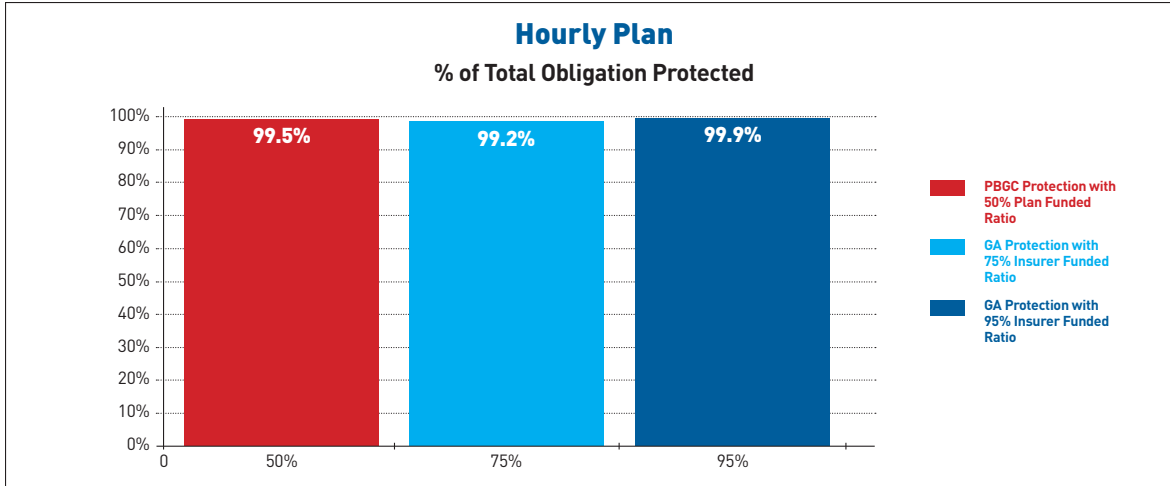
The Willis Towers Watson quantitative comparison assumed that, in each failure scenario, the failed payer’s funded ratio (assets to liabilities) was the same for the pension plan as for the comparable annuity issuer. Historical data, however, demonstrate first that failures of life insurers writing annuities are rare, while pension plan failures are more common; and second that, in the relatively rare cases when insurance companies have failed, their funded ratios have been materially higher on average than the funded ratios of failed pension plans. NOLHGA’s records reflect that, between 1991 and 2015, and excluding the effects of the anomalous ELNY liquidation, the average funded ratio for insolvencies of annuity issuers was about

76%; when the effects of the ELNY liquidation are included, the funded ratio for all annuity issuer insolvencies was about 71%.<sup>103</sup> Under modern insurance company solvency monitoring and testing that has evolved since the mid-1990s, and the prompt corrective action authority since given to insurance company regulators, the funded ratio of a major annuity issuer that might fail can reasonably be expected to be significantly higher than the historical average funded ratio of failed annuity issuers.<sup>104</sup> Since that regulatory change, in fact, no active issuer of annuity contracts has failed.

By contrast, according to the PBGC’s most recent Data Book, the average funded ratio for failed pension plans for the 1990–2013 period was about 52%.<sup>105</sup> The funded ratio is particularly important with a failed annuity issuer, because annuitants’ benefits in excess of state guaranty levels are allocated a significant share of the insurer’s remaining assets. For that reason, a more realistic comparison emerges by contrasting how individuals would fare at (i) the funded ratios typical of failed pension plans, with (ii) the higher funded ratios typical of failed insurers, or the even higher funded ratio that reasonably could be expected in the unlikely event of the insolvency of one of the country’s largest annuity issuers (the type of insurer that pension fiduciaries typically select for de-risking transactions).

The following graphs and tables provide that comparison for the hourly, salaried, and retiree populations in the Willis Towers Watson Study for hypothesized pension plan failures at the 50% funded ratio, compared to insurer failures at both the 75% and the 95% funded ratio levels. For each plan, the bar graph reflects the percentage of total payment obligations protected in the three scenarios. Immediately following each bar graph is a table that shows for the same group the levels of protection provided to all individuals in that group.

### THREE: How the Systems Protect Benefits After Payer Insolvency

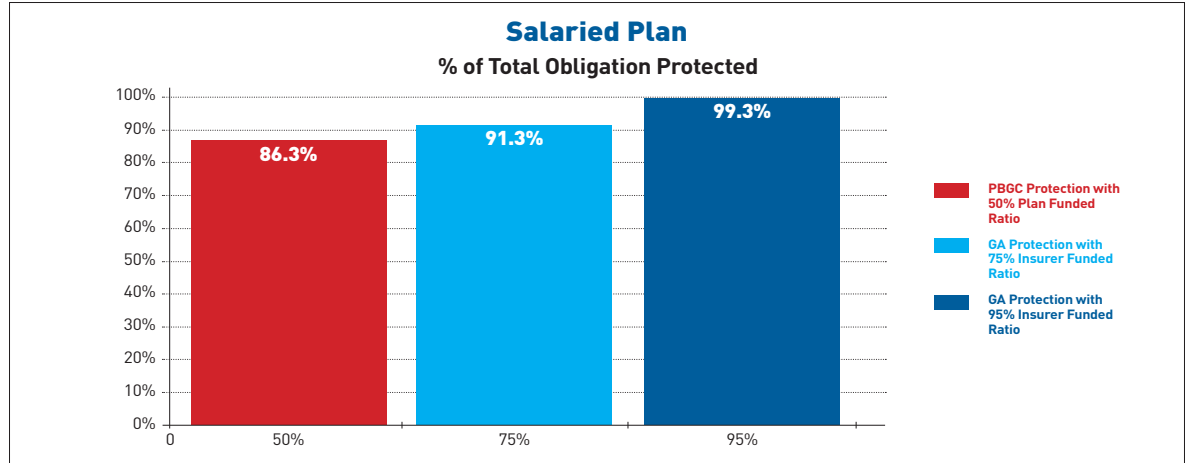


#### Hourly Plan

Protection ratios experienced by individuals	PBGC with 50% plan funded ratio—individuals by protection range	GA with 75% insurer funded ratio—individuals by protection range	GA with 95% insurer funded ratio—individuals by protection range
<20%			
20%-40%			
40%-60%	2		
60%-80%	4		
80%-90%	22	72	
90%-95%	533	247	
95%-98%	1,190	240	72
98%-100%	1,134	172	659
100%	31,152	33,306	33,306
<b>Total</b>	<b>34,037</b>	<b>34,037</b>	<b>34,037</b>



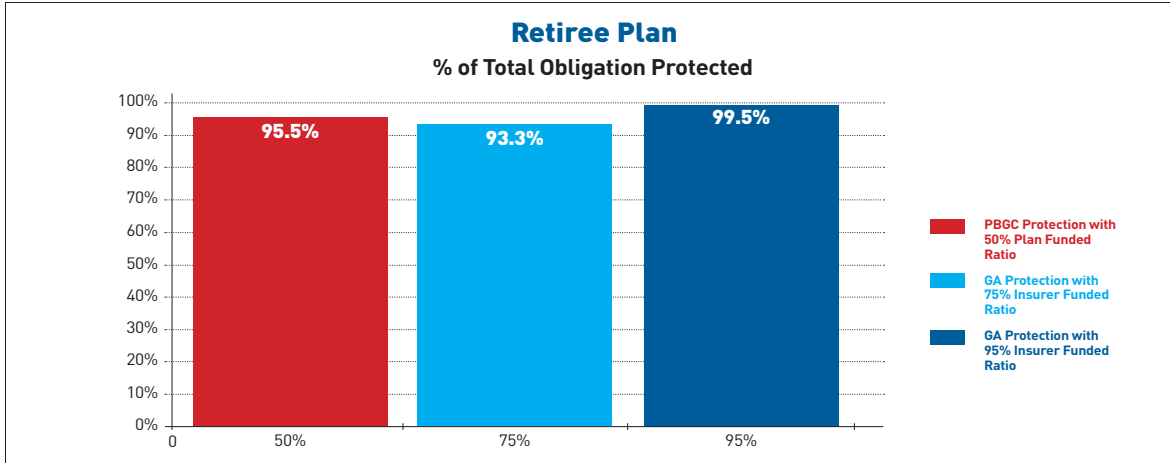
### THREE: How the Systems Protect Benefits After Payer Insolvency



#### Salaried Plan

Protection ratios experienced by individuals	PBGC with 50% plan funded ratio—individuals by protection range	GA with 75% insurer funded ratio—individuals by protection range	GA with 95% insurer funded ratio—individuals by protection range
<20%			
20%-40%	656		
40%-60%	991		
60%-80%	1,280	749	
80%-90%	868	5,445	
90%-95%	445	3,125	
95%-98%	240	1,697	6,194
98%-100%	167	1,156	5,978
100%	60,210	52,685	52,685
<b>Total</b>	<b>64,857</b>	<b>64,857</b>	<b>64,857</b>

### THREE: How the Systems Protect Benefits After Payer Insolvency



#### Retiree Plan

Protection ratios experienced by individuals	PBGC with 50% plan funded ratio—individuals by protection range	GA with 75% insurer funded ratio—individuals by protection range	GA with 95% insurer funded ratio—individuals by protection range
<20%			
20%-40%	7		
40%-60%	111		
60%-80%	144	76	
80%-90%	83	1,361	
90%-95%	34	1,034	
95%-98%	26	646	1,437
98%-100%	16	429	2,109
100%	22,204	19,079	19,079
<b>Total</b>	<b>22,625</b>	<b>22,625</b>	<b>22,625</b>

As shown by the above graphs and tables, in the failure scenarios consistent with what one reasonably could expect, the insurer protection regime would tend to protect the total promised annuity benefit obligations on par with or better than the protections afforded by the pension system for promised pension benefits. On an individual basis, the vast majority of participants and policy holders would be fully protected under both systems, and a minority would experience reductions—some with better protection under the PBGC system and some with better protection under the insurance system.

# Conclusion

**B**oth the federal pension protection system and the state insurance protection system have been in place for many decades, have long interacted with each other, and have developed multi-layered and complex structures and processes to protect consumers. In their objectives and design, the protective systems have similarities, but some of their general approaches and many of their specific techniques differ in significant ways. In practice, both systems provide strong protections for their consumers.

At the first level of protection, both systems employ regulatory techniques to help assure that the private benefit payers—whether private pension plans or private annuity issuers—stay healthy and have sufficient assets to pay promised benefits as they become due. In general, insurance regulators impose more rigorous financial controls on the approximately 460 life insurance companies that issue annuities than the ERISA system employs to police the financial health of about 22,000 pension plans. In addition, the pension system has a significant protection gap not shared by the insurance system: ERISA provides no authority to regulate the financial health of the employers that sponsor pension plans and remain ultimately responsible for their funding.

Actual failure experience has reflected the system differences. In the aftermath of the 2008 financial crisis, no operating annuity issuers with an active book of annuities failed, and only a single former annuity issuer—Executive Life Insurance Company of New York, which had been in receivership since 1991—was placed into liquidation.<sup>106</sup> By comparison, 931 single-employer pension plans failed during that period, affecting over 560,000 pension plan participants.

If a pension plan or insurance company fails financially, both the federal pension system and the state insurance system provide strong benefit protections for individual plan participants and annuity payees. The two systems differ in enough significant respects to make direct comparisons difficult, but both systems cover the vast majority of all benefit claims in the event of payer insolvency. For the relatively small minority of covered individuals not fully protected, and depending on the specific facts of a particular financial failure, each system can provide slightly better benefits than the other in specific individual cases. The Appendix that follows illustrates those outcomes for some specific individual examples drawn from the sample Hourly, Salaried, and Retiree Plans that Willis Towers Watson analyzed in its study.

# Appendix

## INDIVIDUAL PROTECTION EXAMPLES

The case examples in this Appendix are drawn from the sample populations for the Hourly, Salaried, and Retiree Plans that Willis Towers Watson analyzed in its study. As these examples demonstrate, patterns of individual protection under the pension and insurance safety nets vary considerably depending upon many factual variables, including the age and benefit amounts of the individual and other covered individuals, the plan's and insurer's funded ratios, and the allocation of plan obligations and assets among the PBGC priority categories.<sup>A1</sup>

### PLAN-LEVEL ASSUMPTIONS

The comparisons contained in this Appendix of the protections provided to certain individuals assume that the counterpart pension plan and annuity issuer failed with equal funding ratios; that the GA coverage level is \$250,000 per person; that the pension plans have not had recent benefit increases; and that the respective pension plans have benefit obligations that fall into PBGC priority categories as follows:

	PC 3	PC 4	PC 5
Hourly Plan	65%	34%	1%
Salaried Plan	40%	46%	14%
Retiree Plan	96%	3%	1%

Given that spread of benefit obligations among the PBGC priority categories, each pension plan's assets are allocated among the PBGC priority categories in proportions that depend on the pension plan's funded ratio, as described on the following table:

### Hourly Plan

Plan Funded Ratio	Assumed Percentage of Entire Plan's Priority Category Obligation Covered by Assets						
	0%	25%	50%	75%	95%	98%	100%
Priority Categories							
PC 3	0%	38%	77%	100%	100%	100%	100%
PC 4	0%	0%	0%	29%	88%	97%	100%
PC 5	0%	0%	0%	0%	0%	0%	100%

<sup>A1</sup> Federal pension priority categories, shown with a "PC" designation in these examples, are described in the report to which this Appendix is attached at note 90 and the accompanying text.

**Salaried Plan**

	Assumed Percentage of Entire Plan's Priority Category Obligation Covered by Assets						
Plan Funded Ratio	0%	25%	50%	75%	95%	98%	100%
<b>Priority Categories</b>							
PC 3	0%	63%	100%	100%	100%	100%	100%
PC 4	0%	0%	23%	77%	100%	100%	100%
PC 5	0%	0%	0%	0%	65%	86%	100%

**Retiree Plan**

	Assumed Percentage of Entire Plan's Priority Category Obligation Covered by Assets						
Plan Funded Ratio	0%	25%	50%	75%	95%	98%	100%
<b>Priority Categories</b>							
PC 3	0%	26%	52%	78%	99%	100%	100%
PC 4	0%	0%	0%	0%	0%	67%	100%
PC 5	0%	0%	0%	0%	0%	0%	100%

**AN EXAMPLE IN DETAIL**

As an initial detailed example (one of the nine examples summarized below), consider a single individual at age 60 who is eligible for a single life monthly benefit of \$7,549 when a failure occurs. For purposes of determining the level of benefits protected under the federal pension system, assume that the individual could have retired under the Salaried Plan and started receiving a \$5,557 monthly pension benefit under the plan's terms three years before the failure (when the individual was 57). That individual's ultimate level of protection would vary, under both systems, depending on the pension plan's or insurer's funded ratio and, in the PBGC system, also depending on how the individual's benefit falls into the six priority categories—principally PC 3, PC 4, and PC 5.

In this example, under the PBGC system, the monthly amount protected by the PBGC guaranty itself (without taking plan assets into account) would be \$3,213. But if the pension plan's assets were sufficient to pay all plan obligations in priority categories through PC 3, this individual's monthly benefit protection would be \$5,557—all due to the plan's remaining assets. Based on the sample population used by Willis Towers Watson and the allocation of plan assets among priority categories at various plan funded ratios, this individual would have the following levels of ultimate benefit protection:

APPENDIX: Individual Protection Examples

Plan Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	3,213	3,213	3,213	3,213	3,213	3,213	3,213
B. Benefit Covered by Plan Assets							
PC 3	-	3,501	5,557	5,557	5,557	5,557	5,557
PC 4	-	-	-	-	-	-	-
PC 5	-	-	-	-	1,295	1,713	1,992
Total Protection from Plan Assets	-	3,501	5,557	5,557	6,852	7,270	7,549
<b>Final Protected (Greater of A or B)</b>	<b>3,213</b>	<b>3,501</b>	<b>5,557</b>	<b>5,557</b>	<b>6,852</b>	<b>7,270</b>	<b>7,549</b>

Note that, under the pension system, the individual is protected at the greater of either (A) the PBGC guaranteed benefit level or (B) the benefits supported by the participant’s share of the failed pension plan’s assets (determined by priority categories)—but not both. Since a monthly benefit of \$5,557 falls in PC 3 (the monthly pension benefits the individual could have received three years before the pension plan failure), this individual’s protection would be determined by the pension plan’s assets, not the PBGC guaranty, at funded ratios near 25% and above. And this individual would not receive additional protection unless the pension plan’s funded ratio reached about 85%, well above the historical 52% average funded ratio for failed pension plans.

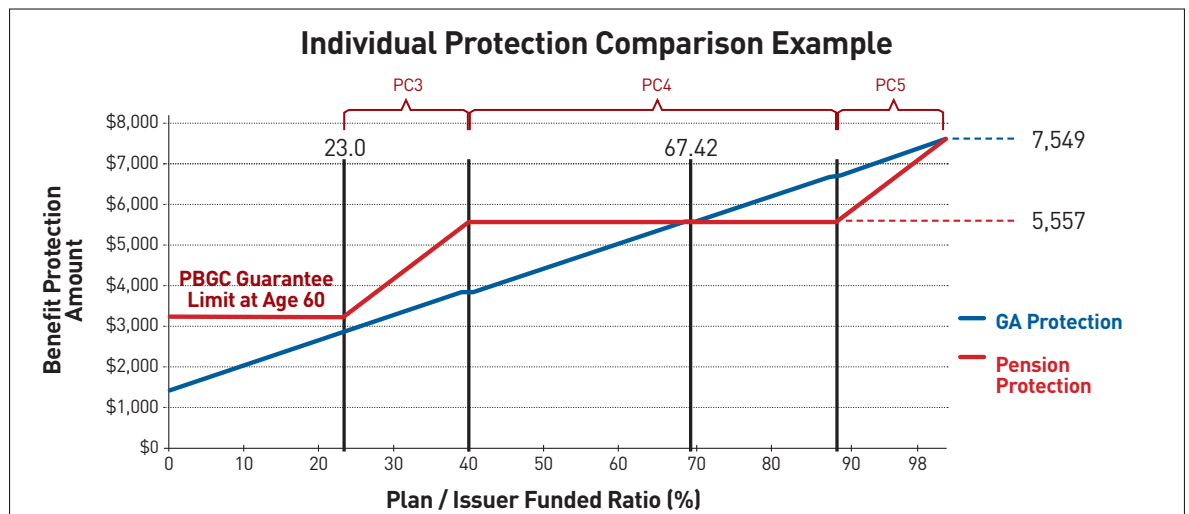
APPENDIX: Individual Protection Examples

The following table illustrates how the same individual, receiving the same \$7,549 single life benefit under an annuity, would fare if the insurer failed at various funded ratios:

		Final Annuity Benefit Protection Determination						
Insurer Funded Ratio	0%	25%	50%	75%	95%	98%	100%	
A. Benefit Guaranteed by GA	1,434	1,434	1,434	1,434	1,434	1,434	1,434	
B. Benefit Covered by Insurer Assets	-	1,529	3,057	4,586	5,809	5,992	6,115	
<b>Final Protected (A + B)</b>	<b>1,434</b>	<b>2,963</b>	<b>4,491</b>	<b>6,020</b>	<b>7,243</b>	<b>7,426</b>	<b>7,549</b>	

As the table illustrates, under the insurance system, the individual’s protection is the sum of both (A) the GA coverage level and (B) the insurer’s remaining assets allocated to the benefits in excess of the GA coverage level (which are allocated proportionately among all annuity benefits). So for benefits in excess of GA coverage levels, the ultimate protection increases proportionately as the failed insurer’s funded ratio increases. At a funded ratio of 75%, which historically has been more typical for failed life insurers, this individual would receive higher protection under the state insurance system (\$6,020 monthly) than under the federal pension system (\$5,557 monthly). In fact, insurance system protection for this individual would overtake, and remain higher than, pension system protection at funded ratios of more than 67.4%.

The following graph demonstrates, for this example, each system’s change in protected benefits at the various funded ratios. The insurance system protection (shown by the blue line) grows ratably with the funded ratio. By contrast, the growth in pension system protection (shown by the red line) is interrupted by a plateau caused by the allocation of pension plan assets among priority categories.



## SUMMARY OF ALL EXAMPLES

The following examples (which include the example described in detail above) involve three individuals having different ages and benefit amounts (expressed as the monthly amount of a single-life annuity), and they analyze each individual’s comparative protections as if the individual were covered under the Hourly Plan, the Salaried Plan, or the Retiree Plan. In some examples, the assumed benefit amounts may be more realistic for some plans than for others, but they are used across all three plans to illustrate how the safety nets operate.

The insurance system’s safety net gives all annuity holders an equal-priority claim against the insurer’s remaining assets, so while an individual’s protection increases ratably with the insurer’s funded ratio, it follows the same pattern in the Hourly Plan, the Salaried Plan, and the Retiree Plan. By contrast, the pension safety net assigns differing priorities among participants’ claims to plan assets. For that reason, an individual’s protection under the pension system’s safety net can vary considerably from plan to plan, depending on the plan’s overall allocation of benefit obligations and plan assets among the priority categories.

### INDIVIDUAL 1

Age = 60

Monthly benefit amount = \$7,549

PBGC maximum guaranty = \$3,213

For this individual (discussed above in more detail with respect to the Salaried Plan), whose benefit exceeds the PBGC guaranteed amount and some of which falls into PC 3, the insurance system protection begins below the pension system protection at zero funded ratios, but overtakes pension system protection at relatively low funded ratios. The precise cross-over point varies by the plan—under a 50% funded ratio for the Hourly Plan and the Retiree Plan (both of which have relatively high concentrations of PC 3 benefits) and slightly under a 75% funded ratio for the Salaried Plan.

### Individual 1—Insurance System—All Plans

Insurer Funded Ratio	Final Annuity Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by GA	1,434	1,434	1,434	1,434	1,434	1,434	1,434
B. Benefit Covered by Insurer Assets	-	1,529	3,057	4,586	5,809	5,992	6,115
<b>Final Protected (A + B)</b>	<b>1,434</b>	<b>2,963</b>	<b>4,491</b>	<b>6,020</b>	<b>7,243</b>	<b>7,426</b>	<b>7,549</b>



APPENDIX: Individual Protection Examples

**Individual 1-H—PBGC System—Hourly Plan**

Insurer Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	3,213	3,213	3,213	3,213	3,213	3,213	3,213
B. Benefit Covered by Plan Assets							
PC 3		2,112	4,279	5,557	5,557	5,557	5,557
PC 4	-	-	-	-	-	-	-
PC 5	-	-	-	-	-	-	1,992
Total Protection from Plan Assets	-	2,112	4,279	5,557	5,557	5,557	7,549
<b>Final Protected (Greater of A or B)</b>	<b>3,213</b>	<b>3,213</b>	<b>4,279</b>	<b>5,557</b>	<b>5,557</b>	<b>5,557</b>	<b>7,549</b>
<b>Protected by Insurance System</b>	<b>1,434</b>	<b>2,963</b>	<b>4,491</b>	<b>6,020</b>	<b>7,243</b>	<b>7,426</b>	<b>7,549</b>

**Individual 1-S—PBGC System—Salaried Plan**

Plan Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	3,213	3,213	3,213	3,213	3,213	3,213	3,213
B. Benefit Covered by Plan Assets							
PC 3		3,501	5,557	5,557	5,557	5,557	5,557
PC 4	-	-	-	-	-	-	-
PC 5	-	-	-	-	1,295	1,713	1,992
Total Protection from Plan Assets	-	3,501	5,557	5,557	6,852	7,270	7,549
<b>Final Protected (Greater of A or B)</b>	<b>3,213</b>	<b>3,501</b>	<b>5,557</b>	<b>5,557</b>	<b>6,852</b>	<b>7,270</b>	<b>7,549</b>
<b>Protected by Insurance System</b>	<b>1,434</b>	<b>2,963</b>	<b>4,491</b>	<b>6,020</b>	<b>7,243</b>	<b>7,426</b>	<b>7,549</b>

**Individual 1-R—PBGC System—Retiree Plan**

Plan Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	3,213	3,213	3,213	3,213	3,213	3,213	3,213
B. Benefit Covered by Plan Assets							
PC 3		1,445	2,890	4,334	5,501	5,557	5,557
PC 4	-	-	-	-	-	-	-
PC 5	-	-	-	-	-	-	1,992
Total Protection from Plan Assets	-	1,445	2,890	4,334	5,501	5,557	7,549
<b>Final Protected (Greater of A or B)</b>	<b>3,213</b>	<b>3,213</b>	<b>3,213</b>	<b>4,334</b>	<b>5,501</b>	<b>5,557</b>	<b>7,549</b>
<b>Protected by Insurance System</b>	<b>1,434</b>	<b>2,963</b>	<b>4,491</b>	<b>6,020</b>	<b>7,243</b>	<b>7,426</b>	<b>7,549</b>

**INDIVIDUAL 2**

Age = 56

Monthly benefit amount = \$4,784

PBGC maximum guaranty = \$2,422

This slightly younger individual has a benefit that exceeds the PBGC guaranteed amount, and none of that benefit falls within PC 3. Under the pension safety net, the individual receives only the PBGC guaranteed amount, without additional protection from plan assets, until the plan's funded ratio reaches very high levels—above 98% for the Hourly and Retiree Plans (which have high PC 3 concentrations) and well above 75% for the Salaried Plan (with lower PC 3 concentrations). The insurance safety net's protection overtakes the pension safety net's protection at relatively low funded ratios, well below 50%, in all three plans.

**Individual 2—Insurance System—All Plans**

Insurer Funded Ratio	Final Annuity Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by SGA	1,323	1,323	1,323	1,323	1,323	1,323	1,323
B. Benefit Covered by Insurer Assets	-	865	1,731	2,596	3,288	3,392	3,461
<b>Final Protected (A + B)</b>	<b>1,323</b>	<b>2,188</b>	<b>3,054</b>	<b>3,919</b>	<b>4,611</b>	<b>4,715</b>	<b>4,784</b>

**Individual 2-H—PBGC System—Hourly Plan**

Insurer Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	2,422	2,422	2,422	2,422	2,422	2,422	2,422
B. Benefit Covered by Plan Assets							
PC 3	-	-	-	-	-	-	-
PC 4	-	-	-	702	2,131	2,349	2,422
PC 5	-	-	-	-	-	-	2,362
Total Protection from Plan Assets	-	0	0	702	2,131	2,349	4,784
<b>Final Protected (Greater of A or B)</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>4,784</b>
<b>Protected by Insurance System</b>	<b>1,323</b>	<b>2,188</b>	<b>3,054</b>	<b>3,919</b>	<b>4,611</b>	<b>4,715</b>	<b>4,784</b>

**Individual 2-S—PBGC System—Salaried Plan**

Insurer Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	2,422	2,422	2,422	2,422	2,422	2,422	2,422
B. Benefit Covered by Plan Assets							
PC 3	-	-	-	-	-	-	-
PC 4	-	-	533	1,841	2,422	2,422	2,422
PC 5	-	-	-	-	1,512	2,031	2,362
Total Protection from Plan Assets	-	0	533	1,841	3,934	4,453	4,784
<b>Final Protected (Greater of A or B)</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>3,934</b>	<b>4,453</b>	<b>4,784</b>
<b>Protected by Insurance System</b>	<b>1,323</b>	<b>2,188</b>	<b>3,054</b>	<b>3,919</b>	<b>4,611</b>	<b>4,715</b>	<b>4,784</b>

**Individual 2-R—PBGC System—Retiree Plan**

Insurer Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	2,422	2,422	2,422	2,422	2,422	2,422	2,422
B. Benefit Covered by Plan Assets							
PC 3	-	-	-	-	-	-	-
PC 4	-	-	-	-	-	1,623	2,422
PC 5	-	-	-	-	-	-	2,362
Total Protection from Plan Assets	-	0	0	0	0	1,623	4,784
<b>Final Protected (Greater of A or B)</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>2,422</b>	<b>4,784</b>
<b>Protected by Insurance System</b>	<b>1,323</b>	<b>2,188</b>	<b>3,054</b>	<b>3,919</b>	<b>4,611</b>	<b>4,715</b>	<b>4,784</b>

APPENDIX: Individual Protection Examples

**INDIVIDUAL 3**

Age = 72

Monthly benefit amount = \$7,896

PBGC maximum guaranty = \$10,944

This older individual, with a benefit lower than the PBGC maximum, has full protection under the PBGC system under plans at all funded ratios. The insurance safety net provides high levels of protection at high funded ratios, but does not reach full protection so long as the funded ratios are under 100%.

**Individual 3—Insurance System—All Plans**

Insurer Funded Ratio	Final Annuity Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by SGA	2,033	2,033	2,033	2,033	2,033	2,033	2,033
B. Benefit Covered by Insurer Assets	-	1,466	2,932	4,397	5,570	5,746	5,863
<b>Final Protected (A + B)</b>	<b>2,033</b>	<b>3,499</b>	<b>4,965</b>	<b>6,430</b>	<b>7,603</b>	<b>7,779</b>	<b>7,896</b>

**Individual 3—PBGC System—All Plans**

Insurer Funded Ratio	Final Pension Benefit Protection Determination						
	0%	25%	50%	75%	95%	98%	100%
A. Benefit Guaranteed by PBGC	7,896	7,896	7,896	7,896	7,896	7,896	7,896
B. Benefit Covered by Plan Assets	n/a*	n/a*	n/a*	n/a*	n/a*	n/a*	n/a*
<b>Final Protected (Greater of A or B)</b>	<b>7,896</b>	<b>7,896</b>	<b>7,896</b>	<b>7,896</b>	<b>7,896</b>	<b>7,896</b>	<b>7,896</b>

\* At different funded ratios, plan assets would be allocated differently among PBGC priority categories, but in this example, the PBGC guaranteed amount would always determine the protection amount.

---

# End Notes

1. In fact, plans typically pay more to purchase annuity contracts than the liability value previously recognized for plan funding purposes and employer financial statements. According to testimony before the ERISA Advisory Council in 2013, “generally annuities are 5% to 15% higher than the value of the same pension promises under the plan.” Private Sector Pension De-Risking and Participant Protections, Advisory Council on Employee Welfare and Pension Benefit Plans [hereinafter, ERISA Advisory Council Report], page 15 (November 2013); available at <http://www.dol.gov/ebsa/pdf/2013ACreport2.pdf>. In one of the largest annuity-purchase transactions, for example, the Verizon plan paid the insurer a total of \$8.4 billion, \$1 billion more than the amount of the transferred liabilities previously recognized by the Verizon plan. *Lee v. Verizon Commc’ns, Inc.*, 2014 WL 1407416 (N.D. Tex. Apr. 11, 2014), affirmed per curiam 623 Fed. Appx. 132, 60 EBC 1309 (5th Cir. 2015), cert. granted, vacated and remanded 578 U.S. \_\_\_, --- S.Ct. ----, 2016 WL 2945235 (Mem), 84 USLW 3354 (May 23, 2016) (vacated and remanded only on standing of those participants remaining in the Verizon plan to bring a claim). More recently, changing mortality assumptions have generally been causing employers to recognize increased pension liability, bringing annuity purchase costs, on average, to approximately a 5% premium over the employer’s pension liability. Mercer Pension Buyout Index, available at <http://www.mercer.us/our-thinking/mercer-us-pension-buyout-index.html>.
2. In mid-2015, the Internal Revenue Service announced regulation changes that prospectively prohibit pension plans from offering lump-sum payments to participants who are already receiving annuity payments. I.R.S. Notice 2015-49 (July 9, 2015).
3. This report does not analyze the detailed procedures, advantages, and disadvantages of de-risking through lump-sum window programs; it focuses, instead, on de-risking through annuity-purchase transactions.
4. In his 2013 testimony before the ERISA Advisory Council, then-PBGC Director Gotbaum “stated that he did not think that a defined benefit plan with a PBGC guarantee was necessarily safer than an insurance company annuity backed by a state insurance guaranty association.” ERISA Advisory Council Report, p. 12.
5. In addition, plan participants also receive different types of “conduct of business” protections under both systems. Under ERISA, plan participants rely significantly on the right to hold plan administrators and other fiduciaries accountable under fiduciary conduct standards. Payees and beneficiaries of annuities are protected both through contractual rights and by an extensive system of conduct-of-business regulation by state insurance commissioners, acting both independently and through the National Association of Insurance Commissioners.

## End Notes

---

6. When this report refers to a “pension plan” without further description, it is referring to a defined benefit pension plan sponsored by a single employer (and its controlled group affiliates) in the private sector. Unless otherwise noted, it is not referring to multiemployer plans (often called Taft-Hartley plans), to defined contribution retirement plans, or to plans sponsored by governmental entities.
7. ERISA §206(g), 29 U.S.C. §1056(g). For a discussion of the popularity of, and problems with, using 80% as a general indicator of adequate pension funding, see American Academy of Actuaries Issue Brief, July 2012, available at [https://www.actuary.org/files/80\\_Percent\\_Funding\\_IB\\_071912.pdf](https://www.actuary.org/files/80_Percent_Funding_IB_071912.pdf).
8. See *infra* notes 103 and 105 and accompanying text; see also discussions in Part THREE under “Actual Pension Benefit Loss Experience” and “Actual Insurance Benefit Loss Experience.” The technical terms applicable to pension plans under federal law and to insurance companies under state insurance law are different. For ease of comparison, this paper uses the generic terms “failed” or “failure” to mean: (1) for pension plans, the plan’s “distress termination” or “involuntary termination,” resulting in the Pension Benefit Guaranty Corporation’s takeover of the pension plan; and (2) for insurance companies, the entry of a court order of liquidation against the insurer with a finding of insolvency, thereby triggering the state guaranty associations. When this report refers to a “funded ratio” without further description, it is referring to the ratio of the market value of an insolvent entity’s remaining assets to the present value of the entity’s current and future liabilities to plan participants or annuity payees, as the case may be. Those values depend on assumptions that often differ from one context and purpose to another, but a detailed examination of those differences is beyond the scope of this report. For further discussion of typical sources and levels of funding in life insurer insolvencies and historical outcomes for contract owners and payees, see *infra* at Part THREE under “Actual Insurance Benefit Loss Experience.”
9. The Pension Benefit Guaranty Corporation was created “within the Department of Labor as a body corporate” and given “the powers conferred on a nonprofit corporation” under District of Columbia law. ERISA §1302, 29 U.S.C. §4002. The United States “is not liable for any obligation or liability of the [PBGC].” ERISA §1302(g)(2), 29 U.S.C. §4002(g)(2). The lack of financial backing from the United States is highlighted by the PBGC in its annual reports. See, e.g., Public Benefit Guaranty Corporation Annual Report for Fiscal Year 2015, 51(Nov. 16, 2015), <http://www.pbgc.gov/documents/2015-annual-report.pdf> (“ERISA requires that PBGC programs be self-financing. ERISA provides that the U.S. Government is not liable for any obligation or liability incurred by PBGC.”) [hereinafter PBGC 2015 Annual Report].

10. The District of Columbia, Puerto Rico, and all states in the United States have enacted statutes substantially similar to a Model Law promulgated by the National Association of Insurance Commissioners. Each such statute creates, for that jurisdiction, a guaranty association that protects annuitants and insureds under annuities and life insurance policies. See National Association of Insurance Commissioners, Model Laws, Regulations and Guidelines, Vol. III, Life and Health Insurance Guaranty Association Model Act, 520-1 (2009), <http://www.naic.org/store/free/MDL-520.pdf> [hereinafter Model GA Act]. The state guaranty associations are generally “nonprofit legal entit[ies].” See *id.* at §6. All licensed life insurance companies are required to be members of each state guaranty association, and the guaranty association is authorized to assess all member insurers to obtain the funds it needs to protect annuitants and insureds. See *id.* at §§6, 9. Each guaranty association is also entitled to assets from each insolvent insurer allocable to the annuity and insurance obligations the guaranty association protects. See *id.* at §§8K & 14C.
11. Willis Towers Watson has authorized NOLHGA to reference its analysis and results in this report and in presentations to or discussions with third parties, provided that NOLHGA specifically discloses that Willis Towers Watson performed its analysis using a specific set of methods and assumptions; that the analysis and conclusions are based strictly on and are subject to the data, methods, and assumptions stated; that the results of that analysis may not be applicable to other situations; and that any changes in the methods, assumptions, or data used could materially change the conclusions. Willis Towers Watson, *Analysis of Plan Participant Protections Provided by the Pension Benefit Guaranty Corporation (PBGC) and Insured Annuitant Protections Available via State Insurer Receiverships and State Guaranty Associations (SGA)* (2016) [hereinafter Willis Towers Watson Study].
12. Patrick W. Seburn, *Evolution of Employer-Provided Defined Benefit Pensions*, United States Dep’t of Labor, Monthly Labor Review (December 1991), <http://www.bls.gov/mlr/1991/12/art3full.pdf> [hereinafter Seburn Article].
13. ERISA, Pub. L. No. 93-406, 88 Stat. 829 (September 2, 1974).
14. ERISA §2, 29 U.S.C. §1001.
15. The Department of Labor has primary regulatory authority over Title I of ERISA, “Protection of Employee Benefit Rights.” ERISA §§2 et seq., 29 U.S.C. §§1001 et seq. The Treasury Department has primary regulatory authority over Title II of ERISA, which amended the Internal Revenue Code. The Pension Benefit Guaranty Corporation has primary regulatory authority over Title IV of ERISA, “Plan Termination Insurance.” ERISA §§4001 et seq., 29 USC §§1301 et seq.
16. ERISA §4041, 29 U.S.C. §1341.
17. Pension Benefit Guaranty Corporation, Pension Insurance Data, Pension Insurance Data Tables 2013, Tables S-30 (Insured Plan Participants), S-31 (Insured Plans), S-33 (Workforce Percentage) (2013), <http://www.pbgc.gov/prac/data-books.html>; PBGC 2015 Annual Report.
18. ERISA §514(a), (b)(2)(A), 29 U.S.C. §1144(a), (b)(2)(A) (stating that ERISA does not “exempt or relieve any Person from any law of any State which regulates insurance”).



## End Notes

---

19. ERISA §4002(d), 29 U.S.C. §1302(d).
20. ERISA §4005, 29 U.S.C. §1305.
21. Public Benefit Guaranty Corporation, Premium Rates, (2015), <http://www.pbgc.gov/prac/prem/premium-rates.html>.
22. ERISA §4002(g)(2), 29 U.S.C. §1302(g)(2).
23. Public Benefit Guaranty Corporation, 2013 Projections Report FAQs, (June 30, 2014), <http://www.pbgc.gov/about/projections-report/projections-report-faq.html>. See also Public Benefit Guaranty Corporation, New PBGC Projections: Solvency of Multiemployer Program Fund Extended Three Years; Condition of Single-Employer Program Continues to Improve (September 28, 2015) (projecting some improvement, but still projected to run out of funds 2025), [http://www.pbgc.gov/news/press/releases/pr15-09.html?CID=COLA01ACSEP2820151&source=govdelivery&utm\\_medium=email&utm\\_source=govdelivery](http://www.pbgc.gov/news/press/releases/pr15-09.html?CID=COLA01ACSEP2820151&source=govdelivery&utm_medium=email&utm_source=govdelivery).
24. Division O of the Consolidated and Further Continuing Appropriations Act of 2015, Pub. L. No. 113-235, 128 Stat. 2130 (December 16, 2014).
25. PBGC 2015 Annual Report, *supra* note 9, at 3, 25.
26. Public Benefit Guaranty Corporation Annual Report for Fiscal Year 2008, 2, 9 (Nov, 13, 2008), [https://www.pbgc.gov/docs/2008\\_annual\\_report.pdf](https://www.pbgc.gov/docs/2008_annual_report.pdf).
27. National Association of Insurance Commissioners, *State Insurance Regulation: History, Purpose and Structure*, [http://www.naic.org/documents/consumer\\_state\\_reg\\_brief.pdf](http://www.naic.org/documents/consumer_state_reg_brief.pdf).
28. *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). Congress responded with the McCarran Ferguson Act, 15 U.S.C. §§1011-15 (2012).
29. *U.S. Dept. of Treasury v. Fabe*, 508 U.S. 491 (1993).
30. See *supra* note 27.
31. FAWG is a Working Group of the NAIC Financial Condition (E) Committee. Information about FAWG's charges can be found at [http://www.naic.org/committees\\_e\\_fawg.htm](http://www.naic.org/committees_e_fawg.htm). FAWG's primary charge is to "[a]nalyze nationally significant insurers and groups that exhibit characteristics of trending toward or being financially troubled; [and] determine if appropriate action is being taken."
32. U.S. domestic insurance companies are not eligible for federal bankruptcy protection. 11 U.S.C. §109(b), (d). Insurance companies that become financially impaired or insolvent are subject exclusively to the insurance company conservation, rehabilitation, and liquidation statutes of the state where the insurance company is domiciled.

33. See Model GA Act, *supra* note 10, at 520-45 (noting that NAIC first adopted the model act in 1971).
34. Peter G. Gallanis, *Policyholder Protection in the Wake of the Financial Crisis*, in *Modernizing Insurance Regulation*, (John H. Biggs & Matthew P. Richardson ed., 2014) [hereinafter Gallanis Chapter].
35. National Association of Insurance Commissioners, Receivership and Insolvency (E) Task Force, *Communication and Coordination Among Regulators, Receivers, and Guaranty Associations: An Approach to a National State Based System*, (2004), <http://www.naic.org/store/free/CAC-OP.pdf>.
36. Gallanis Chapter, *supra* note 34, at 217.
37. See *supra* note 10.
38. In addition to the assessments and estate assets, the GAs also assume the right to receive all premiums under covered policies due from insureds after the order of liquidation, and they are authorized to continue reinsurance contracts the insolvent insurer had in place, and to receive purchase proceeds (commonly referred to as “ceding commissions”) for any books of covered policies the GAs sell to a solvent assuming insurer.
39. See *supra* note 10 and accompanying text.
40. See, e.g., the insolvencies of the following companies: Mutual Benefit Life Insurance Company, information available at <https://www.nolhga.com/companies/public/main.cfm?NAICCode=66362>; Confederation Life Insurance Company, information available at <https://www.nolhga.com/companies/public/main.cfm?NAICCode=80667>; London Pacific Life & Annuity Company, information available at <http://www.nolhga.com/companies/public/main.cfm?NAICCode=68934>; and Kentucky Central Life Insurance Company, information available at <http://www.nolhga.com/companies/public/main.cfm?NAICCode=65188>.
41. James M. Poterba, *The History of Annuities in the United States*, National Bureau of Economic Research, (April 1997), <http://www.nber.org/papers/w6001.pdf>; Seburn Article.
42. ERISA §514(b)(2), 29 U.S.C. §1144(b)(2).
43. ERISA §403(b), 29 U.S.C. §1103(b); *John Hancock Mutual Life Insurance Co. v. Harris Trust & Savings Bank*, 510 U.S. 86 (1993).
44. See 29 C.F.R. §§2520.103-8(a), 2520.104-21.
45. 29 C.F.R. §2510.3-3(d)(2)(ii).
46. Field Assistance Bulletin No. 2015-02 3 (Dep’t of Labor July 13, 2015), <http://www.dol.gov/ebsa/pdf/fab2015-2.pdf>. See also Safe Harbor Rule, 29 C.F.R. §2550.404a-4 (providing a safe harbor for individual account plans for satisfying ERISA fiduciary duties in certain transactions); Dep’t of Labor and Dep’t of Treasury Joint Request for Information, 75 Fed. Reg. 5253 (Feb. 2, 2010) (requesting information related to a joint review of ERISA and plan qualification tax rules).

## End Notes

---

47. ERISA §4041(b)(3)(A)(i), 29 U.S.C. §1341(b)(3)(A)(i).
48. 29 C.F.R. § 2510.3-3(d)(2)(ii).
49. 29 C.F.R. §2509.95-1(c)(5) (Interpretive bulletin clarifying the fiduciary standards under ERISA when selecting an annuity provider for a defined benefit plan).
50. Although obvious, it is still important to note that prevention of insolvencies also minimizes the social costs of invoking the safety net mechanisms, which, like all public goods, have direct and indirect social costs.
51. ERISA §403(a), 29 U.S.C. §1103(a); ERISA §404, 29 U.S.C. §1104; ERISA §4044(d), 29 U.S.C. §1344(d).
52. Affiliates that are members of the plan sponsor’s “controlled group” are jointly and severally liable. ERISA §4001(a)(14), 29 U.S.C. §1301(a)(14); ERISA §4062(b), 29 U.S.C. §1362(b).
53. ERISA §302, 29 U.S.C. §1082; ERISA §4041(b), 29 U.S.C. §1341(b).
54. A detailed description of stochastic testing, which may be required for insurance companies but not for pension plans, is beyond the scope of this report. In short, to evaluate assets held to meet future payment obligations, stochastic testing compares a wide range of assumptions—which may include varying interest rates, investment returns, default rates, and other factors—with long-term, mortality-adjusted payment obligations, to project multiple future cash flow scenarios to determine the probability that the invested assets will be adequate to meet the payment obligations. The deterministic method for evaluating whether a plan (or an insurance company) is financially sound utilizes a single set of assumptions at a point in time. While either approach ultimately depends on the reasonableness of the underlying assumptions, the deterministic method may not be as rigorous or as robust as stochastic testing for evaluating the financial ability of either a plan or an insurance company to meet its future benefit payment obligations. Moreover, insurance companies are required to assess reserve adequacy using moderately adverse assumptions.
55. Although the PBGC invests approximately 70% of its assets in fixed-income securities, federal law requires that the PBGC report its returns as compared against an “ERISA Benchmark”—a hypothetical portfolio “used as a benchmark for a typical pension plan, rather than an insurer” with a 60% equity allocation. PBGC 2015 Annual Report, *supra* note 9, at 11, 44.
56. See generally Society of Actuaries, *Pension Risk Transfer: Evaluating Impact and Barriers for De-Risking Strategies* (2014), <https://www.soa.org/Research/Research-Projects/Finance-Investment/Pension-Risk-Transfer.aspx>.
57. ERISA §206(g), 29 U.S.C. §1056(g).
58. See ERISA §404, 29 U.S.C. §1104.

59. See *generally* ERISA Title I, Subtitle B, Part 1, 29 U.S.C. §1021 *et seq.*
60. ERISA §501, 29 U.S.C. §1131; ERISA §502, 29 U.S.C. §1132.
61. See *generally* ERISA Title IV, Subtitles A and C; 29 U.S.C. §§1301 *et seq.*, 1341 *et seq.*
62. ERISA §4041, 29 U.S.C. §1341.
63. 4010 Summary Report, Attachment to Letter from Joshua Gotbaum, Director, Pension Benefit Guaranty Corporation, to Senator Tom Harkin, Chairman, Senate Committee on Health, Education, Labor, and Pensions (August 21, 2012), *available at* <http://www.pbgc.gov/documents/PBGC-4010-report-harkin.pdf>.
64. Public Benefit Guaranty Corporation Annual Report 2009, 3 (Nov, 12, 2009), [https://www.pbgc.gov/docs/2009\\_annual\\_report.pdf](https://www.pbgc.gov/docs/2009_annual_report.pdf).
65. Milliman, Pension Funding Index, (January 2016), <http://us.milliman.com/PFI>; Mercer, S&P 1500 pension funding status (January 5, 2016), <http://www.mercer.com/newsroom/december-2015-pension-funding.html>.
66. Willis Towers Watson, Corporate Pension Plan Funding Levels (January 4, 2016), <https://www.towerswatson.com/en-US/Press/2016/01/corporate-pension-plan-funding-levels-showed-little-change-in-2015>.
67. See U.S. Gov't Accountability Office, GAO-13-583 *Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis*, at 10-12 (June 27, 2013), *available at* <http://www.gao.gov/assets/660/655612.pdf> [hereinafter GAO Insurance Study].
68. By contrast, pension plans do not have the ability to issue equity or debt to raise needed funding for the plan's operations, but a plan's sponsor could do so and has the legal obligation to fund the plan obligations. Nonetheless, different market dynamics may apply in the case of raising capital to support core business operations (in the life insurance company context), as compared to raising capital to meet "sunk cost" obligations outside of the entity's core business operations (in the context of funding pension plan liabilities).
69. 29 C.F.R. §2509.95-1(c)(5); *supra* note 49 and accompanying text.
70. This approach spreads the solvency risk between two insurers and results in twice the level of GA protection, because that protection is provided on a per-insolvent insurer basis.
71. See *generally* Part 3.3.2 of the NAIC standards. <http://www.actuarialstandardsboard.org/asops/statements-opinion-based-asset-adequacy-analysis-actuaries-life-health-insurers/> (requiring that an insurer's reserves reflect moderately adverse assumptions).

## End Notes

---

72. See National Association of Insurance Commissioners, *Model Laws, Regulations and Guidelines, Vol. III, Risk-Based Capital (RBC) For Insurers Model Act, 520-1* (2009), <http://www.naic.org/store/free/MDL-312.pdf>. The critical standards utilized in RBC calculations, such as “Total Adjusted Capital,” “Company Action Level RBC,” “Authorized Control Level RBC,” etc., are defined in the Model Law and in the various state statutes adopting the Model Law. The actual formulas for calculating these amounts are published by the NAIC.
73. The “Authorized Control Level RBC” is the number each insurer must calculate annually under the risk-based capital formula in accordance with the NAIC’s RBC Instructions. See *supra* note 72.
74. National Association of Insurance Commissioners, Summary: Aggregate Life RBC Results By Year, (June 23, 2015), [http://www.naic.org/documents/research\\_stats\\_rbc\\_results\\_life.pdf](http://www.naic.org/documents/research_stats_rbc_results_life.pdf).
75. See National Association of Insurance Commissioners, Model Laws, Regulations and Guidelines, Vol. III, Investments of Insurers Model Act (Defined Limits Version), (October 1996), <http://www.naic.org/store/free/MDL-280.pdf> [hereinafter Model Investment Law].
76. See Model Investment Law 13B. See also NAIC & The Center for Insurance Policy and Research, Capital Markets Special Report, [http://www.naic.org/capital\\_markets\\_archive/130809.htm](http://www.naic.org/capital_markets_archive/130809.htm). Common stock and preferred stock invested in unaffiliated entities totaled 4.9% of total cash and invested assets of the insurance industry year-end 2012. For life insurers the percentage of investments in equities of unaffiliated entities was reportedly much lower, at 0.8% of cash and admitted assets. See *supra* note 55 regarding typical asset allocations for pension plan investments.
77. See Model Investment Law 10A.
78. See GAO Insurance Study, *supra* note 67, at 6–7.
79. See also pages 10–12 of MetLife 2013 written testimony delivered to the ERISA Advisory Council, available at <http://www.dol.gov/ebsa/pdf/MetLife082913.pdf>.
80. See generally GAO Insurance Study, *supra* note 67.
81. Standard Life insurance Company of Indiana was placed into liquidation in 2012, but all of the annuities it originally issued had been transferred to and assumed by a solvent insurer a year before liquidation. The only insurer with outstanding annuity obligations placed into liquidation in the years following the “Great Recession” was Executive Life Insurance Company of New York (“ELNY”). The financial failure of ELNY, however, dates back decades, to an era before states implemented important new safeguards (e.g., the RBC capital framework) that would make a repeat of the ELNY scenario unlikely. Formal receivership proceedings for ELNY began in 1991, when ELNY was seized and placed into rehabilitation by the New York Department of Insurance following the failure of its parent, Executive Life Insurance Company. ELNY wrote no annuities after its 1991 seizure. The ELNY rehabilitation proceedings continued until 2013, when ELNY

became subject to an order of liquidation. ELNY suffered from the same problems of the 1980s that caused its parent to fail—underpricing of large structured settlement annuities and heavy investments in the junk bond market. ELNY’s 2013 liquidation was the last chapter in that 1991 insolvency. ELNY’s liquidation affected approximately 10,000 annuity contracts and certificates, which represents a very small portion of the overall annuity marketplace. Almost half of ELNY’s remaining 10,000 annuity contracts and certificates (more than 4,700 annuity certificates) were held by individuals who received them in pension plan terminations that occurred in the 1980s. At liquidation, 99.8% of the former plan participants were fully protected by the GAs under the ELNY liquidation plan, and 98.6% of their aggregate benefits were protected. Approximately 1,400 other annuities were not fully covered due to their very large size (some having present values in excess of \$20 million) and the anomalously low funded ratio of the ELNY estate at the time liquidation commenced in 2013.

82. See generally, R. Boyd, *Fatal Risk: A Cautionary Tale of AIG’s Corporate Suicide* (Wiley 2011).
83. See, e.g., *supra* note 74.
84. *Id.*
85. National Association of Insurance Commissioners, *State of the Life Insurance Industry: Implications of Industry Trends*, (August 2013), [http://www.naic.org/documents/cipr\\_home\\_130823\\_implications\\_industry\\_trends\\_final.pdf](http://www.naic.org/documents/cipr_home_130823_implications_industry_trends_final.pdf).
86. Of course, as noted above, a plan’s sponsor may have access to capital markets; however, it may be more feasible for an insurer to raise capital to support its core business operations than for a plan sponsor to raise capital to fund pension obligations that are outside its core business operations.
87. Public Benefit Guaranty Corporation, *Maximum Monthly Guarantee Tables*, <http://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.html>. The amounts for joint-and-survivor annuities assume spouses of the same age as the participants.
88. For a large plan (with at least \$20 million in unfunded benefits), the recovery ratio is based on the recovery for that plan alone; for smaller plans, the recovery ratio is the average ratio for all such plans over a 5-year period. ERISA §4044(f)(2)(A), (C), 29 U.S.C. §1344(f)(2)(A), (C). In its December 2011 report on Delphi plan terminations in 2009, the GAO reported that “PBGC would pay about 6 percent of all participant unfunded nonguaranteed plan benefits,” and that “this [6 percent] ratio falls within the range of recovery ratios for other large terminated plans we reviewed.” U.S. Gov’t Accountability Office, GAO-12-168, *Delphi Pension Plans: GM Agreements with Unions Give Rise to Unique Differences in Participant Benefits* 24, 27-28 (December, 2011). The GAO report also noted that, in 2009, the small-plan “ratio was set at 3.85 percent.” *Id.* at 27, n. 68.
89. ERISA §4022(b), 29 U.S.C. §1322(b).
90. ERISA §4044(a), 29 U.S.C. §1344(a).

## End Notes

---

91. Pension Benefit Guaranty Corporation, *PBGC's Guarantee Limits—an Update*, 2 (Sept. 2008), <https://www.pbgc.gov/docs/guaranteelimits.pdf>.
92. The guaranteed minimum level applies to the value of future annuity payments payable after the insurer is placed into liquidation—there is no reduction for the annuity payments the individual has already received. Additionally, the present value coverage level is for each measuring life. For joint-and-survivor annuity benefits, the present value of the benefits payable for the primary life is actuarially determined, and then the present value of benefits payable for the secondary life is actuarially determined. Each present value is protected up to the state's present value coverage level (usually \$250,000). Once the present value of the protected annuity benefits is determined, the annuitant will continue to receive the benefit payments regardless of how long the annuitant lives. So, all mortality and economic risk is assumed by the GA, which may end up paying the annuitant more in benefits than what was used to determine the present value at the time the insurer became insolvent and was placed into liquidation.
93. An insurer's funded ratio at the time of liquidation bears no intrinsic relationship to, and should not be confused with, RBC ratios calculated prior to liquidation.
94. In any state with a \$500,000 present value GA coverage level, the annuity in this example would be fully guaranteed.
95. This outcome assumes no separate account had been established by the insurer to fund the promised annuity benefits. If the insurer had established a separate account, and that account was adequately funded, the annuity benefits backed by the separate account would be fully protected notwithstanding the insurer's insolvency or the level of assets available in the "estate" of the insolvent insurer.
96. While the uncovered benefits are backed by their proportionate share of the insolvent insurer's assets, there is no entity charged with guaranteeing that those remaining assets will ultimately prove to be sufficient to meet all future payment obligations the assets support. Due to investment risk and mortality/longevity risk, those estate assets could prove to be inadequate. For this reason, NOLHGA and its member GAs and receivers often try to transfer the liabilities (either at the commencement of the company's receivership or at a favorable time afterwards) to a solvent insurer that will guarantee the assets are sufficient. Such transactions do have a cost, but they yield guaranties for benefits not covered by the GAs and result in the transfer of administrative responsibilities to an ongoing life insurer actively engaged in the administration of such business.
97. In the ELNY case, as explained in more detail above, 99.8% of former pension plan participants were fully protected under the liquidation plan. See *supra* note 81.
98. For comparative purposes, holders of life insurance policies with failed insurers insurance did somewhat better, having an average loss over the same period of only 3.92%.
99. At NOLHGA's direction, Willis Towers Watson assumed equal funded ratios for a plan and insurer for purposes of comparing quantitatively the two safety net mechanisms. Actual historical patterns, however, demonstrate that failed insurers have substantially higher funded ratios than those of failed pension plans. See *infra* notes 103 and 105 and accompanying text.

- 
100. A Participant Census Data Summary, attached as Appendix I to Willis Towers Watson’s analysis, reflects the key participant data (by headcount, average age, average benefit amount, and employment and benefit-payment status) that Willis Towers Watson used in performing its quantitative comparisons for three plan populations—the hourly employees’ plan, the salaried employees’ plan, and the retiree portion of the salaried employees’ plan. Willis Towers Watson Study, *supra* note 11, at 19.
  101. Willis Towers Watson used the \$250,000 coverage level in the current NAIC Model GA Act at NOLHGA’s direction. Fourteen states currently have higher coverage levels for payout annuities, with four states having limits of \$500,000 (Connecticut, New Jersey, New York, and Washington). Puerto Rico (which is not currently a member of NOLHGA) remains at the \$100,000 coverage levels. *Id.* at 8.
  102. In all scenarios, the allocation of plan or insurer assets would not change the percentage of fully protected participants.
  103. The funded ratio for insolvent annuity issuers is significantly affected by the eventual 2013 liquidation of ELNY, which first entered receivership in 1991. See *supra* note 81. Not only was ELNY anomalous because it occurred prior to implementation of the more rigorous insurance financial oversight standards developed in the 1990s (even though it was not placed into liquidation until 2013), it also suffered from large increases in liabilities as its book of annuity business aged due to its underwriting and pricing practices before receivership. ELNY used aggressive interest rate assumptions and age rating for many annuitants under its largest structured settlement annuities (e.g., treating several annuitants as decades older than their actual age under the belief that the seriousness of their personal injuries had a materially negative impact on life expectancy).
  104. For example, in Confederation Life, one of the largest insolvencies of annuity issuers in history, the funded ratio was ultimately sufficient to protect fully all annuitants (that is, Confederation Life’s funded ratio ultimately proved to be 100%). Even in the Executive Life Insurance Company (CA) insolvency, the funded ratio reached nearly 78% by 2006, and with recent litigation recoveries the ultimate funded ratio will increase further. See *U.S. and Japan Life Insurers Insolvencies Case Studies, Lessons learned from resolutions*, The Geneva Association (2015).
  105. Pension Benefit Guaranty Corporation, Pension Insurance Data Tables 2013, Table S-3 (PBGC Terminations and Claims (1975-2013) Single-Employer Program) (2013), <http://www.pbgc.gov/prac/data-books.html>.
  106. In 2012, Standard Life insurance Company of Indiana was also placed into liquidation, but all of the annuities it originally issued had been transferred to and assumed by a solvent insurer prior to liquidation.













**National Organization of Life and Health Insurance Guaranty Associations**

13873 Park Center Road, Suite 505 | Herndon, VA 20171

Phone: 703.481.5206 | Fax: 703.481.5209

[www.nolhga.com](http://www.nolhga.com)